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# Directors’ Duty of Care in Times of Financial Distress Following the Global Epidemic Crisis

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# DIRECTORS' DUTY OF CARE IN TIMES OF FINANCIAL DISTRESS FOLLOWING THE GLOBAL PANDEMIC CRISIS

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INTRODUCTION

From its emergence in December 2019 through January 2021, there have been more than 100 million COVID-19 infections worldwide, with at least 26 million confirmed cases in United States alone.[1] As a result, companies and businesses around the world are confronted with severe loss of revenue and disrupted supply chains due to shutdown industries and restrictions on movement and commerce. As a result, the rates of unemployment and poverty have increased sharply, and millions of people across the United States and Europe have filed for unemployment.[2] Consequently, governments are collaborating, based on the latest scientific evidence, to prevent the short-term recession from shifting to a global depression by providing a package of legal, economic, and financial reforms.[3] At the same time, corporations, in general, and boards of directors, in particular, are confronted with the challenge of designing specific strategies to address the COVID-19 crisis and its

1. Max Roser, Hannah Ritchie, Esteban Ortiz-Ospina & Joe Hasell, *Coronavirus Pandemic (COVID-19)*, OUR WORLD DATA, https://ourworldindata.org/coronavirus (last visited February 1, 2021).

2. Rosamond Hutt, *The economic effects of COVID-19 around the world*, WORLD ECON. F. (last updated May 14, 2020), https://www.weforum.org/agenda/2020/02/coronavirus-economic-effects-global-economy-trade-travel; Survey, *World Economic Outlook: The Great Lockdown*, INT'L MONETARY FUND (Apr. 2020), https://www.imf.org/en/Publications/GFSR/Issues/2020/04/14/global-financial-stability-report-april-2020 ("It is very likely that this year the global economy will experience its worst recession since the Great Depression, surpassing that seen during the global financial crisis a decade ago.").

3. *See, e.g.*, Patricia Buckley, *US policy response to COVID-19 aims to set the stage for recovery*, DELOITTE INSIGHTS (Apr. 8, 2020), https://www2.deloitte.com/us/en/insights/economy/covid-19/evolution-and-policy-response-to-the-covid-19-crisis.html; European Council Press Release, Report on the Comprehensive Economic Policy Response to the COVID-19 Pandemic (Apr. 9, 2020) ("The COVID-19 pandemic constitutes an unprecedented challenge with very severe socio-economic consequences. We are committed to do everything necessary to meet this challenge in a spirit of solidarity").

aftermath. These plans have to consider different aspects of the organization's business that will ensure the survival of the firm in times of financial distress, such as the possibility of renegotiation with lenders for short or near-term debt service extensions and restructuring different loan guarantees. Moreover, directors are obliged to respond to the potential changes in consumers' preferences and design specific business policies that will tackle such demands under the short availability of suppliers and other service providers. This is especially true for small and medium-sized enterprises (SMEs) that suffered enormous economic loss. Those losses in many cases threaten the continued existence of these companies as ongoing concerns, considering that they have limited access to alternative financial resources, such as raising equity in the capital markets or substituting company debt in exchange for shares.[4]

Accordingly, this article explores directors' duty of care in times of financial distress from a global perspective. It argues that, whereas the financial crunch from 2007 through 2009 was a result of governance failures that yielded vast reforms reinforcing the monitoring role of directors, the current economic crisis will emphasize the importance of their advisory role. Therefore, this article expects legislators and courts to design specific regulatory arrangements that reinforce this function. Further, it argues that the civil law, rather than Anglo-American law, on directors' duty of care provides boards with a wider scope of discretion to confront the challenges associated with COVID-19. The reason is that the civil law involves governance arrangements that are designed following a firm-specific view, which considers the unique features of the company and markets. This article applies this general argument to different types of SMEs, mainly family business firms and venture capital-backed firms.

Part I analyzes the dual role of the board of directors. It argues that the global pandemic will reemphasize the significance of the advisory role of directors. Part II is devoted to exploring the current global landscape of the law regarding directors' duty of care and discusses the complex governance ar-

4. For an extensive overview of the world governments' response to foster SME resilience following the COVID-19 pandemic, *see Coronavirus (COVID-19): SME Policy Responses*, OECD (last updated July 15, 2020), https://read.oecd-ilibrary.org/view/?ref=119_119680-di6h3qgi4x&title=Covid-19_SME_Policy_Responses.

rangements of the civil law in comparison to the uniform standards of responsibility of the Anglo-American tradition. Part III will explain why the civil law's nuanced regimes of care provide directors with superior mechanisms to meet the financial challenges of our times in two concrete types of SMEs: family business and venture capital-backed firms.

## I. THE DUAL ROLE OF THE BOARD OF DIRECTORS

The board of directors is a fundamental institution in the corporate governance structure[5] and is perceived to hold two central roles: advising the management on critical decisions and monitoring management's conduct.[6] This Part is devoted to exploring these general roles and to arguing that, while the financial turnover from 2007 through 2009 has emphasized the oversight function of directors,[7] the current pandemic-induced financial crisis will highlight the advisory function of directors.[8]

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5. For a large survey on the functions of board of directors in corporate governance, *see, e.g.,* Renée B. Adams, *Boards, and the Directors Who Sit on Them*, *in* 1 THE HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE 291, 305 (Benjamin E. Hermalin & Michael S. Weisbach eds., 2017).

6. Stephen M. Bainbridge, *The Board of Directors*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 275, 277–86 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018) ("The role and functions of the board have been defined mainly by nonlegal norms and expectations. Although the board's functions have therefore varied over time, today they can be sorted into three basic categories. These are management, oversight, and service."); J. Robert Brown, Jr., *The Demythification of the Board of Directors*, 52 AM. BUS. L.J. 131, 134 (2015) ("Boards are commonly said to both monitor and advise management."); Kelli A. Alces, *Beyond the Board of Directors*, 46 WAKE FOREST L. REV. 783, 798 (2011) ("The board performs an advisory function, offering advice and opinions to management about general business concerns").

7. Bainbridge, *supra* note 6, at 281–82; Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards,* 66 STAN. L. REV. 1051, 1062 (2014) ("The role of the typical public corporation board shifted from a mainly advisory function in the 1970s to an emphasis by the late 1990s on active and independent monitoring of the top management team.").

8. *See* Jill E. Fisch, *The Overstated Promise of Corporate Governance*, 77 U. CHI. L. REV. 923, 929 (2010) ("Corporations largely have sacrificed the potential value of managing boards in favor of the independent monitoring board."); Jeremy C. Kress, *Board to Death: How Busy Directors Could Cause the Next Financial Crisis*, 59 B. C. L. REV. 877, 884 (2018) ("Perhaps to reconcile these tensions, boards of large, public corporations have, over time, large-

### *A. The Advisory Role of Directors*

Generally, corporate law provides the board of directors with the primary responsibilities concerning the strategy and functioning of the company.[9] The board "advis[es] the CEO and top managers on administrative and other managerial issues, as well as more actively initiating and formulating strategy."[10] The board has a number of primary functions, including presenting strategic direction, overseeing the executive's daily conduct, and approving business objectives and effective corporate designs.[11] The board of directors is also authorized to make decisions such as forming strategic goals and missions with management, taking actions concerning specific matters, such as the election of officers, approving important transactions involving the company's assets, and appointing senior executives and officers.[12] Although the literature has not yet reached a consensus on identifying the board's advisory role and its content, many commentators argue that the advisory roles should be defined in three critical board aspects: service, strategy, and control.[13] The board's service role refers to the role of directors to provide advice and counsel to the CEO and other senior executives.[14] The board's strategy and control roles include the formulation of corporate strategy and supervising its imple-

ly abandoned their advising role and instead focused on monitoring. In response to shareholder pressure and regulatory requirements, companies have dramatically increased the proportion of independent directors comprising their boards in the last several decades. This shift away from manager-directors reflects shareholders' and policymakers' preferences for directors who primarily monitor, rather than advise, management.").

9. Bainbridge, *supra* note 6, at 276 ("Although the differences detail across national boundaries, corporation codes (a.k.a. company laws) establish the board of directors as the key player in the formal decision-making structure.").

10. Jonathan L. Johnson, Catherine M. Daily & Alan E. Ellstrand, *Boards of Directors: A Review and Research Agenda*, 22(3) J. MGMT. 409, 411 (1996).

11. Adams, *supra* note 5, at 305–06.

12. Business Roundtable, *Principles of Corporate Governance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 8, 2016), https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/.

13. Shaker A. Zahra & John A. Pearce, *Boards of Directors and Corporate Financial Performance: A Review and Integrative Model*, 15 J. MGMT 291, 303 (1989); Johnson, Daily & Ellstrand *supra* note 10, at 411–29.

14. *Id*. at 424.

mentation by the management through the provision of expertise.[15]

Several empirical studies point to board characteristics, and more specifically, board composition, capital, identification, commitment, and motivation, as important determinants for board service task performance.[16] For example, board members who possess diverse expertise in areas such as accounting, finance, management, and law play an essential role in the board's advisory function, mainly in cases of complex business decisions.[17] Additionally, financial institutions' outside directors are thought to increase the firm's access to different sources of capital.[18] Also, directors who maintain strong political connections with legislators and regulators can support the company's dealings on critical matters with different public authorities.[19] Moreover, it was observed that a board member's background and diverse knowledge have a positive relationship with service task performance.[20] Research indicates that service task performance increases as board members identify themselves to a larger extent with the firm's operations.[21] Fur-

15. Hanna Maria Sievinen, Tuuli Ikäheimonen & Timo Pihkala, *The Advisory Role of Non-Family Board Members: A Case-Based Study of a Family Firm*, J. MGMT GOVERNANCE 1, 4–6 (2019), https://link.springer.com/content/pdf/10.1007/s10997-019-09496-8.pdf.

16. For an extensive discussion on the empirical evidence on this issue, see, Carl Åberg, Max Bankewitz & Mirjam Knockaert, *Service Tasks of Board of Directors: A Literature Review and Research Agenda in an Era of New Governance Practices*, 37 EUR. MGMT J. 648, 651 (2019).

17. In this respect, the European Commission states that "Diversified expertise is considered the key to efficient board work. A variety of professional backgrounds is needed to ensure that the board as a whole understands, for example, the complexities of global markets, the company's financial objectives and the impact of the business on different stakeholders including employees." *The EU Corporate Governance Framework*, §1.1.1., COM (2011) 164 final; Bainbridge, *supra* note 6, at 279.

18. STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 49 (2012).

19. Bainbridge, *supra* note 6, at 278–79.

20. Patricia Gabaldon, Sadi Bogaç Kanadli & Max Bankewitz, *How Does Job-Related Diversity Affect Boards' Strategic Participation? An Information-Processing Approach*, 51(6) LONG RANGE PLANNING 937, 947 (2018) (finding that job-related diversity contributes to boards' strategic participation through directors' use of knowledge and skills).

21. *See generally* Sylvie Guerrero & Michel Seguin, *Motivational Drivers of Non-executive Directors, Cooperation, and Engagement in Board Roles,* 24 J. MANAGERIAL ISSUES 61 (2012) (finding that nonexecutives' pro-organizational

ther, trust between board members and the CEO has been found to positively impact service task performance relating to the creation of cooperative behavior and positive board dynamics.[22] Therefore, a recent study reveals that service task performance has a significant positive impact on firm financial outcomes.[23]

Recently, J. Robert Brown argued that boards do not perform a significant advisory role.[24] Since directors have inherent authority to intervene in corporate affairs, including the right to dismiss top executives, the potential for directors' intervention has grown. Therefore, management is incentivized to reduce this risk by ensuring that the board consists of directors who favor the positions taken by the CEO. To maintain this result, executives may push for the appointment of members to the board of directors who are inclined toward adopting the policies of the management.[25] This may also be accomplished by withholding information from the board and reducing its ability to monitor management's performance, thereby eliminating the advisory role of the board and diminishing the cooperative connection between the management and directors.[26] Such an outcome will narrow the board's function to oversight of manage-

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motivation is positively related to cooperation and engagement in board roles. This relationship is stronger when needed for achievement and need for identification are higher); Dmitri Melkumov, Eric Breit & Violetta Khoreva, *Directors' Social Identifications and Board Tasks: Evidence from Finland*, 23 CORP. GOVERNANCE: INT'L REV. 42 (2015) (finding that organizational identification is positively related to the level of board task involvement).

22. Pingying Zhang, *Power and Trust in Board–CEO Relationships*, 17 J. MGMT. & GOVERNANCE 745, 754, 759–761 (2011) ("[P]roviding evidence that board trust in the CEO reduces relational risks between the board and the CEO, which improves board control task performance.")

23. Sung Wook Joh & Jin-Young Jung, *When Do Firms Benefit from Affiliated Outside Directors? Evidence from Korea*, 26 CORP. GOVERNANCE: INT'L REV. 397, 404–08 (2018) (presenting evidence that firms with more affiliated outside directors—especially those with social ties—have greater firm value).

24. Brown, *supra* note 6, at 154.

25. Brown, *supra* note 6, at 152–53.

26. *Id.* at 162. *See also* Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987 (2010) (noting that "By the same token, we believe that CEOs involve board members more in major strategic decisions and that board members have become more willing to share any concerns over operations with their CEOs outside the boardroom.").

ment's conduct, resulting in the relationship between the board and management to be more adversarial than cooperative.[27]

Brown's observation concerning the risk of removal of the board's advisory role is supported by a recent empirical study on the trust relationship between directors and management.[28] The study surveys, across a number of different cultures, how the perception of fairness between directors and the CEO influence the directors' inclination to provide resources and monitor the CEO's behavior.[29] The researchers show that board members may provide significant assistance to the CEO when those directors believe that the CEO treats them with respect and dignity.[30] Moreover, they demonstrate that emotional and psychological support between directors and the CEO is strongly and positively associated with the inclination of directors to provide resources to the CEO in countries with robust individualist cultures.[31] In individualistic countries, this effect might be attributed to the culture's emphasis on relational interactions and their impact on "self-concept and self-esteem."[32] Thus, this study indicates that directors will be more inclined to provide advisory resources to CEOs who treat them with respect by sharing essential information on the operations of the company and by forming close collaborations regarding the company's strategy.

### *B. The Oversight Role of Directors*

Alongside its advisory role, the board maintains a monitoring role. The board of directors is responsible for mitigating the agency costs that arise with the divergence of interests between the shareholders and management in diffuse ownership structure, and between controlling and minority shareholders

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27. Brown, *supra* note 6, at 158–62.

28. *See generally* Esther B. Del Brio, Rosa M. Hernandez-Maestro & Toru Yoshikaya, *How Does Interpersonal Justice Affect Outside Directors' Governance Behavior? A Cross-Cultural Comparison*, 12 REV. MANAGERIAL SCI. 683 (2018).

29. *See generally id.*

30. *Id.* at 687, 702.

31. *Id.* at 703 ("Our findings indicate that CEO interpersonal justice is more positively associated with resource provision for directors in Canada than in Singapore and Spain, supporting the argument that individuals in a highly individualistic culture emphasize fair treatment by other individuals.")

32. *Id.* at 692.

in concentrated ownership structure.[33] At the same time, directors in general and independent directors in particular are highly dependent on the extent of information management chooses to provide them in board meetings.[34] Moreover, there are often professional or social ties between the management and independent directors that might impair the director's judgment in assessing the management conduct. Those social ties can result in an unwillingness of independent directors to confront management, especially because they are dependent on them for reappointment.[35] Due to structural bias, the longer the tenure of an individual director, the smaller the likelihood that he will voice his opinion in a manner that might endanger the persistence of those social ties.[36] In addition, the effectiveness with which independent directors can perform their monitoring duties is likely to be restrained by their duties arising from pursuits outside the focal firm.[37] Most independent directors have full-time jobs, and many also have multiple board offices. The time and cognitive attention that they provide to those outside demands inherently reduce their overall ability to

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33. *See* Yaron Nili & Kobi Kastiel, *"Captured Boards": The Rise of "Super Directors" and the Case for a Board Suite*, 2017 WIS. L. REV. 19, 22 n.18 (2017) ("[T]he board is charged with a monitoring role, making sure that shareholder interests are fully served, in an effort to constrain the agency costs associated with a managerial centric corporation model.").

34. *Id*. at 23. Similarly, Kelli Alces argued that "the board of directors has outlived its purpose . . . Responsibility for the success or failure of the firm lies with a group of professionals, the board of directors, who work part time to monitor the firm's business, and management, who receive almost all of their information about the firm secondhand." Alces, *supra* note 6, at 783–85. She observes that corporate officers and investors (including creditors) are the "*real"* corporate decision makers. *Id.*

35. Yaron Nili, *The 'New Insiders': Rethinking Independent Directors' Tenure*, 68 HASTINGS L. J. 97, 118–20 (2016).

36. Id. at 118–21. Fairfax suggests several other reasons why independent directors of large public corporations may not be up to the task of monitoring, such as: the size and complexity of modern corporations' business; the scope of the oversight duty may be unmanageable; directors may lack the capacity needed for the task; do not possess time and information required for the job. Lisa M. Fairfax, *The Uneasy Case for Insider Director,* 96 IOWA L. REV. 127, 164–67 (2010); Lisa M. Fairfax, *Managing Expectations: Does the Directors' Duty to Monitor Promise More Than It Can Deliver?,* 10 U. ST. THOMAS L.J. 416, 441–48 (2012).

37. Yaron Nili, *Horizontal Directors*, 114 NW. U. L. REV. 1179, 1181–82 (2020).

be effective at the focal firm.[38] Those constraints limit the ability of the board to independently obtain complete information regarding the company's operations, a prerequisite to the board's ability to perform its monitoring role adequately.[39]

Considering these limitations, several commentators have offered various solutions. For instance, Usha Rodrigues argued that the board's central role should be confined to monitoring CEO performance and pay, overseeing the audit function, and handling takeovers and derivative suits.[40] Regarding conflicts of interest, the board's lack of ties to management becomes a strength, and so it is on these subjects that the board functions should be focused.[41] Stephen Bainbridge and Todd Henderson argued that directors are "part-timers, the vast majority of whom have fulltime employment elsewhere,"[42] and suffer from a severe information asymmetry vis-à-vis the fulltime managers they purportedly supervise.[43] As a result, although both investors and society at large rely on corporate directors to play a central role in corporate governance by overseeing management teams, there is little confidence that modern boards are optimally structured to perform such tasks efficiently.[44] Therefore, they proposed outsourcing the board of directors' functions to a separate entity, which they termed "board service providers" (BSPs).[45] Accordingly, corporations would be required to hire another entity to act as the corporation's board of directors and provide it with director services. Akin to other service

38. Steven Boivie, Michael K. Bednar, Ruth V. Aguilera & Joel L. Andrus, *Are Boards Designed to Fail? The Implausibility of Effective Board Monitoring*, 10 ACAD. MGMT. ANNALS 1, 16 (2016).

39. For recent empirical study demonstrating that independent directors have been co-opted by management in a manner that undermines their ability to protect shareholder interests against self-interests of members of top management, *see* S. Burcu Avci, Cindy A. Schipani & H. Nejat Seyhun, *The Elusive Monitoring Function of Independent Directors*, 21 U. OF PA. J. OF BUS. L. 235 (2019).

40. Usha Rodrigues, *A Conflict Primacy Model of the Public Board*, 2013 U. ILL. L. REV. 1051, 1070–81 (2013).

41. *Id.*

42. Bainbridge & Henderson, *supra* note 7, at 1063–64.

43. *Id.* at 1065–66.

44. Stephen Bainbridge, *Rethinking the Board of Directors: Getting Outside the Box*, 74 BUS. LAW. 285 (2019).

45. Bainbridge & Henderson, *supra* note 7, at 1068.

firms, BSPs would unify the various aspects of director services under one single roof.[46]

Kobi Kastiel and Yaron Nili argued that to achieve a meaningful monitoring outcome, the law should create a new institution within the board: the "Board Suite."[47] Such a suite is a dedicated office within the board and consists of a special counsel that would serve as an information facilitator, and will be appropriately staffed and designed in regards to the size of the company.[48] The main functions of such an office will be to independently collect and share valuable business information with the members of the board by eliminating the needs of directors to approach the management for obtaining essential data.[49] Moreover, Jennifer O'Hare argued that, in the absence of clear fiduciary duties of officers to provide information to the board, the bylaws of all public companies should include a specific provision entitled the "Duty to Inform Bylaw."[50] A duty to inform bylaw would impose upon the CEO and the Chief Financial Officer a duty to immediately inform the board of all information necessary to enable the board to manage the company's affairs in accordance with its statutory and fiduciary obligations.[51]

### *C. The Move Towards the Monitoring Model and the Future Reemergence of the Advisory Role of the Board of Directors*

The relative balance between the advisory model and monitoring functions has shifted over time. Survey data suggests that in the 1970s, boards had a mainly advisory role, and from the 1990s, an emphasis was given to the managerial functions reflected in policymaking and setting strategy.[52] Since the early 2000s, the role of the board has primarily been limited to over-

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46. STEPHEN M. BAINBRIDGE & M. TODD HENDERSON, OUTSOURCING THE BOARD: HOW BOARD SERVICE PROVIDERS CAN IMPROVE CORPORATE GOVERNANCE 87–103 (2018).

47. Nili & Kastiel, *supra* note 33, at 52–56.

48. *Id*. at 52–53.

49. *Id*. at 54–55.

50. Jennifer O'Hare, *Private Ordering and Improving Information Flow to the Board of Directors: The Duty to Inform Bylaw*, 53 U. OF RICHMOND L. REV. 557, 608–10 (2019).

51. *Id*. at 596–608.

52. See *generally* Renée B. Adams, Benjamin E. Hermalin & Michael S. Weisbach, *The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey*, 48 J. ECON. LIT. 58 (2010).

sight of the company's senior management conduct.[53] This development has mainly occurred due to the enactment of Sarbanes-Oxley legislation and the Dodd-Frank Act in the United States.[54] Both acts enhanced the oversight role of the boards of directors at the expense of the advisory function following the financial crisis of the years 2007–2008.[55] Those regulations included major governance reforms that anchor the oversight of directors over the remunerations of executives and the risks involved in their conduct.[56] However, this Article argues that the emphasis given to the oversight function, rather than the advisory function, has hampered companies' ability to properly confront financial crises that are a product of objective economic emergencies, rather than those arising from global systematic governance failures.[57] Several surveys indicate that independent directors in the United States devote much more time to monitoring the conduct of management than providing advice on corporate strategy and policies. For instance, a survey conducted in 2016 by PricewaterhouseCoopers LLP, the large professional services firm, showed that directors want to spend more time on strategy than on structuring executive remuneration.[58] Specifically, 61% of the respondents claimed that they

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53. Bainbridge, *supra* note 6, at 281–82.

54. *Id.* at 282. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 U.S.C (2012)); Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010).

55. Bainbridge, *supra* note 6, at 282.

56. Renee M. Jones & Michelle Welsh, *Toward a Public Enforcement Model for Directors' Duty of Oversight*, 45 VAND. J. TRANSNAT'L L. 343, 346 (2012) ("The monitoring model forms the basis of the Sarbanes-Oxley reforms that sought to strengthen the hand of independent directors vis-à-vis corporate management"); Melvin A. Eisenberg, *The Board of Directors and Internal Control*, 19 CARDOZO L. REV. 237, 239 (1997) ("the monitoring model of the board has been almost universally accepted").

57. Olubunmi Faleye, Rani Hoitash & Udi Hoitash, *The Trouble With Too Much Board Oversight*, 54 MIT SLOAN MGMT. REV. 53, 54–55 (2013) ("Conversely, corporate innovation suffered when the board monitored intensely. Companies with such boards invested less in R&D, received fewer patents overall and received fewer influential patents as measured by the frequency of citations of the patents they received. Moreover, we found that companies in which directors were more focused on oversight had poorer short- and long-run acquisition performance.")

58. *The Swinging Pendulum: Board Governance in the Age of Shareholder Empowerment*, PWC: GOV. INSIGHTS CENTER (Oct. 2016),

would like additional boardroom time devoted to structuring and discussing strategy policies.[59] In addition, directors are the least interested in devoting more time to executive compensation.[60] This may be due to companies and practitioners expending extensive energy over the last several years to designing effective say-on-pay policies.[61] Thus, there is a concern that in a rush for preferring monitoring over and above other board responsibilities, such as succession planning and counsel, boards are increasingly unready to address crisis management or issues affecting the long-term health of firms.[62]

This observation is also supported in several empirical studies. For example, Renée B. Adams showed that directors vary in how important they perceive their monitoring and advisory roles in a survey of the population of directors of listed companies in Sweden.[63] In particular, she demonstrated that where directors have devoted significant time to oversight duties, they received less strategic information from management.[64] Further, directors who consider their role to consist primarily in monitoring do not feel that they need to significantly engage in board discussions or that the CEO values their contribution.[65] These findings raise doubts about whether increasing the mon-

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http://www.lexissecuritiesmosaic.com/gateway/sec/speech/assets_pwc-2016-annual-corporate—directors—survey.pdf.

59. *Id.* at 17.

60. *Id.*

61. *Id.*

62. Marta Geletkanycz & Brian K. Boyd, *Research Governance and Practice in the 21st Century: Taking Stock of Board Reforms*, *in* RESEARCH HANDBOOK ON BOARDS OF DIRECTORS 292 (Jonas Gabrielsson, Wafa Khlif & Sibel Yamak eds., 2019); Dominic Barton & Mark Wiseman, *Where Boards Fall Short*, HARV. BUS. REV. (2015), https://hbr.org/2015/01/where-boards-fall-short ("Most governance experts would agree that public company directors need to put in more days on the job and devote more time to understanding and shaping strategy").

63. *See generally* Renée B. Adams, *Asking Directors About Their Dual Roles* (Eur. Corp. Governance Inst. Working Paper Series in Fin., Paper No. 243/2009, 2009).

64. *See generally id.* at 16–18

65. *Id.* at 18 ("The results in Columns VIII-XI indicate that directors who perceive their advisory role to be greater are more likely to have an opinion and to voice their views in decision-making and to feel that their inputs are valued. In contrast, directors who perceive their monitoring role to be stronger are less likely to participate and feel that their inputs are valued less by the CEO… They also highlight that directors who perceive their monitoring role to be stronger perceive that they contribute less to decision-making").

itoring strength of the board will necessarily lead directors to be more productive, as governance standards often implicitly assume.[66] Moreover, another study showed that intense monitoring reduces the effectiveness of directors in strategic advising.[67] When directors' expertise and information exchange between the CEO and directors are crucial to ensuring optimal results, intense monitoring reduces board effectiveness by disrupting the relationship between those two parties.[68] As a result, intense board oversight is associated with lower acquisition announcement returns, lower post-merger operating performance, longer time to acquisition completion, and reduced corporate innovation.[69] This same study showed that overcommitting independent directors to monitoring duties, when the need for advising is substantial, significantly reduces directors' effectiveness and firm value.[70] Furthermore, other research showed the contribution of directors to firm resilience by assessing the relative importance of their advisory and monitoring roles at times of distress.[71] Based on manually collected US data,[72] the authors examined the value of the advisory function relative to the monitoring one in times of firm-specific crisis, focusing on the board characteristics, such as independence, size, the presence of directors with industry expertise and directors' busyness.[73] The empirical results indicated that advising-inclined boards are more valuable than monitoring-inclined ones. In particular, they found that more members of the board who are independent and possess industry expertise are associated with a more negative market reaction in case of crisis.[74] In contrast, directors' busyness, as well as larger boards, positively affected the reaction to disruptive events. They found that being a busy director is a signal that the person is more talented and has incentives to devote his attention to the dis-

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66. *Id.* at 28.
67. Olubunmi Faleye, Rani Hoitash & Udi Hoitash, *The Costs of Intense Board Monitoring*, 101 J. FIN. ECON. 160, 173 (2011).
68. *Id.*
69. *Id.*
70. *Id.* at 176–78.
71. Ettore Croci, Gerard Hertig, Layla Khoja & Luh Luh Lan, *The Advisory and Monitoring Roles of the Board - Evidence from Disruptive Events* 23 (Eur. Corp. Governance Inst. Finance Working Paper No. 673/2020, 2020).
72. *Id.* at 10–13.
73. *Id.* at 2–10.
74. *Id.* at 19–20.

rupted firm.[75] Moreover, because disruptive events are generally associated with complexity of business decision-making, larger boards may be considered to be more effective for minimizing the negative consequences of disruptive events.[76] These findings exemplify that "firms [are] benefitting more from boards that are less hands-on monitors and more hands-off advisors when there is a negative shock."[77]

Given the renewed importance of the advisory role of the board of directors in the current, pandemic-induced financial crisis, it can be expected that in the near future, legislators and courts will design various regulatory reforms that reinforce the advisory functions of directors in a way that will assist directors in tackling the challenges associated with the pandemic's economic and social consequences. Alternatively, financial regulators may act to lessen the regulatory burden imposed on directors to enable them to invest more substantial managerial resources required to ensure the survival of companies.[78] Accordingly, the next sections focus on the global regimes of directors' fiduciary duties, and, in particular, on the duty of care. They also explore whether those duties are properly suited to regulate directors' conduct in this new era. This article demonstrates that the civil law's directors' fiduciary duties are sensitive to the unique features of the company and the markets and, therefore, are more appropriate than the Anglo-American law to confront current challenges. Finally, this article applies this argument to different two types of SMEs: the family business firm and the startup firm.

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75. *Id*. at 9.

76. *Id*. at 8.

77. *Id*. at 4.

78. *See, e.g.*, Order Under Section 36 of the Securities Exchange Act of 1934 Modifying Exemptions from the Reporting and Proxy Delivery Requirements for Public Companies, Exchange Act Release No. 88,465, 85 Fed. Reg 17,610 (Mar. 25, 2020); Press Release, Sec. and Exchange Commission, SEC Extends Conditional Exemptions from Reporting and Proxy Delivery Requirements for Public Companies, Funds, and Investment Advisers Affected by Coronavirus Disease 2019 (COVID-19) (Mar. 25, 2020), https://www.sec.gov/news/press-release/2020-73; *Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis*, FIN. CONDUCT AUTH. (Aug. 4, 2020), https://www.fca.org.uk/news/statements/listed-companies-recapitalisation-issuances-coronavirus (the UK FCA announced a series of measures aimed at assisting companies to raise new share capital in response to the coronavirus crisis while retaining an appropriate degree of investor protection).

## II. THE GLOBAL LANDSCAPE OF DIRECTORS' DUTY OF CARE

This Part is devoted to exploring the patterns of directors' duty of care in different legal systems. It demonstrates that, while Anglo-American law provides a uniform standard of care that is applicable across various industries, civil law's nuanced standards of conduct for directors that depend on the director's position and personal characteristics, type and condition of the firm, and other relevant aspects of the markets, are better equipped to respond to crises of the type caused by the COVID-19 pandemic. This discrepancy has significant implications for providing directors with the necessary mechanisms and scope of discretion to confront the negative results of the financial crisis.

### *A. The Anglo-American Law*

This section discusses the Anglo-American approach on directors' duty of care by focusing on the fundamentals of their standard of care concerning corporate decision-making.

#### 1. American Law

Under Delaware corporate law,[79] the duty of care is encompassed in the fiduciary duties imposed on directors and mangers.[80] The duty of care focuses on informed decision-making. Accordingly: "Directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they

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79. Delaware has long been the dominant state in the United States for attracting business incorporations, especially incorporations of the most powerful and profitable firms. *See, e.g.*, Darian M. Ibrahim & Brian J. Broughman, *Delaware's Familiarity*, 52 SAN DIEGO L. REV. 273, 275 (2015) (demonstrating that Delaware's continued success is explained by the familiarity of business parties with Delaware law after decades of dominance).

80. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("[D]irectors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with the requisite care in the discharge of their duties."); *see generally* Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 J. CORP. L. 647, 648 (2015) ("the duty of care is not simply an ill-fitting appendage to the duty of loyalty, but rather an essential aspect of the singular fiduciary concept that also encompasses the duty of loyalty.")

must then act with requisite care in the discharge of their duties."[81]

Moreover, directors have a duty "to exercise oversight" and to monitor the corporation's operational viability, legal compliance, and financial performance.[82] For a plaintiff to prevail in an action alleging a violation of the duty of care, they must show that a fiduciary acted in bad faith—that is, either "(a) the directors utterly failed to implement any reporting or information system or information system or controls; or (b) having implemented such a system or controls, [the directors] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[83] A director may be held liable if he acts in bad faith; that is, he made no good faith efforts to ensure that the company had in place effective system of controls.[84] Since corporate law's liability regime is based on the assumption that directors and not shareholders are responsible for managing the company's business affairs, Delaware courts adopted the presumption that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[85] This presumption, known as the "business judgment rule," is justified on the merits of several rationales.[86]

First, because shareholders are better positioned to diversify the risks involved in their corporate investments, they do not want directors to carry business decisions with risk-aversion.[87]

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81. Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963).

82. *See* In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970–71 (Del. Ch. 1996). *See also* In Marchand v. Barnhill, 212 A.3d 805 (Del. 2019).

83. Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006).

84. *Id.*

85. Julian Velasco, *The Diminishing Duty of Loyalty*, 75 WASH. & LEE L. REV. 1035, 1045 (2018). *See also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

86. For helpful discussion of the business judgment rule's evolution, see D. Gordon Smith, *The Modern Business Judgment Rule*, in RESEARCH HANDBOOK ON MERGERS & ACQUISITIONS 83, 83–84 (Claire A. Hill & Steven Davidoff Solomon, eds., 2016).

87. As Chancellor Allen explained in Gagliardi v. Trifoods Int'l, Inc., shareholders want directors to take risk: "Shareholders can diversify the risks of their corporate investments. Thus, it is in their economic interest for the corporation to accept in rank order all positive net present value invest-

Therefore, the law negates directors from assuming liability for taking good faith risks by avoiding the use of simple negligence standard.[88] Moreover, even where it is possible to hold directors responsible for a breach of the duty of care, Delaware law requires that directors acted with gross negligence.[89] In *Smith v. Van Gorkom*, the Delaware Supreme Court explained that an uninformed board decision could overcome a court's deference to board authority and create director liability.[90] Accordingly, to establish that a board has made an informed decision, a court must determine "whether the directors have informed themselves 'prior to making a business decision, of all material information reasonably available to them.'"[91] Gross negligence is the standard used to determine if there has been a breach of the directors' duty of care regarding keeping informed of the

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ment projects available to the corporation, starting with the highest risk adjusted rate of return first. Shareholders don't want (or shouldn't rationally want) directors to be risk averse. Shareholders' investment interests, across the full range of their diversifiable equity investments, will be maximized if corporate directors and managers honestly assess risk and reward and accept for the corporation the highest risk adjusted returns available that are above the firm's cost of capital." Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996).

88. As the Delaware Chancery Court explained in In re Lear Corp. Shareholder Litig., ("[p]recisely so as to ensure that directors are not unduly hampered in taking good faith risks, our law eschews the use of a simple negligence standard. Even where it is possible to hold directors responsible for a breach of the duty of care, Delaware law requires that directors have acted with gross negligence. Unless judges are mindful of the substantial difference between a simple negligence and gross negligence standard, the policy purpose served by Delaware's choice of a gross negligence standard risks being undermined.") In re Lear Corp. Shareholder Litig., 967 A.2d 640, 651–52 (Del. Ch. 2008).

89. Generally, the law distinguishes between general negligence and gross negligence. Typically, if a person has not only failed to apply the duty of care as a reasonably prudent person would have exercised, but has also missed achieving the minimum level of care a regular person should have exercised, this person is considered to be grossly negligent. *See* Mo Zhang, *Tort Liabilities and Torts Law: The New Frontier of Chinese Legal Horizon*, 10 RICH. J. GLOBAL L. & BUS. 415, 435–36 (2011). *See also* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 98–100 (1991).

90. *See* Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985). *See also* Bernard S. Sharfman, *The Importance of the Business Judgment Rule*, 14 N.Y.U. J. L. & BUS. 27, 48 (2017).

91. *Van Gorkom*, 488 A.2d, at 872.

company's practices.[92] Thus, the broad discretion held by directors and managers provides them with the necessary means to advance shareholder interests, since it allows them to take significant risks without the constant fear that they will be held liable if those risks materialize.[93]

Second, the business judgment rule is justified in light of the private ordering of corporate governance arrangements, which grant extensive authority to the board to make decisions on behalf of the corporation.[94] In this context, the Delaware Supreme Court has described the rule as "an acknowledgment of the managerial prerogatives of Delaware directors."[95]

Third, there is a concern about the institutional capability of the courts to properly evaluate the merits of business decisions.[96] Judges respect board decision-making because they lack the training and practice of board members in determining what the best corporate decision is, and therefore, defer to the substantive decisions of the board.[97] Thus, inflicting liability on directors may often be a result of "hindsight bias" rather than an objective assessment of their conduct.[98] To avoid the risk of liability, directors and officers "will engage in unnecessary investigations and obtain unnecessary second and third opinions, thereby causing the corporation to incur excessive precaution

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92. *Id.* at 872–73. *See also* Bernard S. Sharfman, *Being Informed Does Matter: Fine Tuning Gross Negligence Twenty Plus Years after Van Gorkom*, 62 BUS. LAW. 135, 154–160 (2006) (recommending that the Delaware courts should adopt a lenient gross negligence standard that can be consistently applied when examining the question of whether a board of directors was adequately informed in making certain business decisions).

93. In re Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009).

94. Sharfman, *supra* note 92, at 43–47.

95. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (quoting Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981)).

96. Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997) ("Courts are ill-fitted to attempt to weight the 'adequacy' of consideration...").

97. Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000) (quoting Lewis v. Vogelstein, 699 A.2d 327, 336 (Del Ch. 1997)); Sharfman, *supra* note 92, at 46.

98. Sharfman, *supra* note 92, at 144 ("Handicapped by "hindsight bias," courts would constantly be tempted to see more negligence than really existed, finding liability in honest decisions that had bad outcomes or appeared inept").

costs."[99] These policy considerations indicate that the overall costs of using fiduciary duty litigation to constrain management conduct may outweigh any benefits that shareholders may maintain in the form of compensating them for the harm incurred.[100]

Generally, Delaware corporate law employs three different standards of judicial review for business decisions by a board of directors.[101] On one end of the spectrum, there is the business judgment rule,[102] which applies when the plaintiff cannot establish that directors engaged in fraud, bad faith, or self-dealing.[103] To rebut the presumption granted by the rule, a plaintiff bears the burden of presenting evidence that directors were at least grossly negligent in not staying appropriately informed of the company's practices or were motivated by interests other than those of the company's stockholders as a whole.[104] On the other side of the spectrum there is the entire

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99. Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. 865, 873 (2005).

100. *Id.* at 879. *See also* Julian Velasco, *Fiduciary Principles in Corporate Law*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 61, 70 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019) ("In duty of care cases, the benefits of judicial review are especially questionable. Not only are unconflicted directors likely to be better decision makers than shareholders or courts, but in addition the risk of ruinous liability would be so great in public corporations that it would lead to excessive risk aversion on the part of directors.").

101. For a detailed discussion on the different standards of judicial review employed by Delaware courts concerning directors' business conduct, *see, e.g.*, Morgan White-Smith, *Revisiting Revlon: Should Judicial Scrutiny of Mergers Depend on the Method of Payment?,* 79 U. CHI. L. REV. 1177 (2012).

102. In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 746–47 (Del. Ch. 2005) ("[t]he business judgment rule is not actually a substantive rule of law, but instead it is a presumption that in making a business decision the directors of a corporation acted on an informed basis and in the honest belief that the action taken was in the best interests of the company.").

103. *Id.* at 747; In re Trados Inc. S'holder Litig., 73 A.3d 17, 43 (Del. Ch. 2013) ("the court merely looks to see whether the business decision made was rational in the sense of being one logical approach to advancing the corporation's objectives.").

104. William M. Lafferty, Lisa A. Schmidt & Donald J. Wolfe, Jr., *A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law*, 116 PENN STATE L. REV. 838, 843 (2012) ("In this context, Delaware courts have defined gross negligence as "reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason.").

fairness rule, which applies in cases where directors are faced with actual conflicts of interest.[105] This rule obligates company directors to establish to the court's satisfaction that the related party transaction was a result of both fair dealing and fair price.[106] Delaware's intermediate standard of review is enhanced scrutiny, which applies to specific and identifiable settings involving potential conflicts of interest where the realities of the decision-making context can undermine the decisions of even independent and disinterested directors.[107] Enhanced scrutiny deals with supposedly "slight" breaches of fiduciary loyalty, where the conflict of interest is potential rather than concrete.[108] Accordingly, courts are required to examine: (1) whether the decision-making process included the adequate information on which directors based their decisions, and (2) whether their actions should be considered reasonable given the circumstances existed when decisions were made.[109]

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105. For example, when a decision was made by a group of directors, that did not comprise a disinterested and independent board majority. In re Trados*,* 73 A.3d at 44 ("Entire fairness, Delaware's most onerous standard, applies when the board labors under actual conflicts of interest.").

106. Weinberger v. UOP, Inc., 457 A.2d 701, 710–11 (Del. 1983) ("The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock . . . However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness."); *see also* Amir N. Licht, *Farewell to Fairness: Towards Retiring Delaware's Entire Fairness Review*, 4 DEL. J. CORP. L. 1, 39–55 (2020) (calling the courts to abolish entire fairness review).

107. Gavin v. Tousignant (In re Ultimate Escapes Holdings, LLC), 551 B.R. 749, 761 (D. Del. 2016).

108. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180–181 (Del. 1986); Chen v. Howard-Anderson, 87 A.3d 648, 682 (Del. Ch. 2014) ("*Revlon* is a standard of review in which 'the reviewing court has leeway to examine the reasonableness of the board's actions under a standard that is more stringent than business judgment review and yet less severe than the entire fairness standard.").

109. In re Zale Corp. S'holders Litig., No. 9388-VCP, 2015 WL 5853693, at *11 (Del. Ch. Oct. 1, 2015).

### 2. United Kingdom Law

The reasons for limiting the duty of care have been less critical in the United Kingdom (UK), where more attention is provided to the issue of accountability.[110] The original standard for directors' duty of care in the UK was one of gross negligence.[111] The common law of directorial duty of care was influenced by the bailment and trusteeship care standards as adapted to the corporate form.[112] The directorial duty was formed in the late nineteenth century and dominated UK company law into the twentieth century.[113] Though influenced by bailment standards, directors were not understood to be perfectly analogous to bailees.[114] Accordingly, "it would not be inaccurate to describe the UK's common law standard as a gross negligence standard" that follows the nineteenth century case law on bailment care standards.[115]

The earliest case to consider the existence and nature of a duty of care concerning directors in the UK was 1742's *The Charitable Corporation v. Sutton*.[116] The general charge that the Chancery Court considered was whether the committee men—i.e., directors—of a credit corporation had behaved with "such a supine and gross negligence of their duty . . . that it will amount to a breach of trust" in failing to appoint an officer whose function was to provide oversight of the activities of other officers.[117] The standard applied by Lord Hardwicke to a bailee who undertook to perform a role, even if unrewarded, was equivalent to the standard that he had articulated for trustees.[118] The *Sutton* ruling articulated the standard of care and diligence required by directors upon the lowest standard

110. Jennifer G. Hill & Matthew Conaglen, *Directors' Duties and Legal Safe Harbours: A Comparative Analysis*, in RESEARCH HANDBOOK ON FIDUCIARY LAW 305, 322 (D. Gordon Smith & Andrew S. Gold eds., 2018).
111. *Id*.
112. DAVID KERSHAW, THE FOUNDATIONS OF ANGLO-AMERICAN CORPORATE FIDUCIARY LAW 230 (2018).
113. *Id*. at 229–82.
114. *Id*. at 230.
115. *Id*. at 270.
116. Charitable Corp. v. Sutton (1742) 2 Atk 400 (Eng.).
117. *Id*. at 643.
118. *Id*. at 406.

possible at that time, one of "gross neglect" or "crassa negligentia."[119]

The modern leading case on the duty of care under UK law is the 1925 decision, *In re City Equitable Fire Insurance Co.*[120] That case concerned the liability of directors and other company officers for losses sustained by the company.[121] The liquidators relied upon the misfeasance provisions of the 1908 Companies (Consolidation) Act, which essentially required willful neglect.[122] In the decision, the judge accepted that "gross negligence" involved a different standard than mere negligence and applied a 19th century subjective standard of negligence, under which a director need not exhibit a higher degree of skill than may reasonably be expected from a person of his knowledge and experience.[123] The Master of the Rolls said:

> If directors act within their powers, if they act with such care as is reasonably to be expected from them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge both their equitable as well as their legal duty to the company.[124]

The standard of gross neglect was regarded as undesirable because it didn't provide sufficient reason for deterring poor

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119. *See* ASIC v Cassimatis (No 8) [2016] FCA 1023, [420] ("Although the Lord Chancellor recognised that liability existed for the honorary directors, the imposition of a standard of "gross neglect" or crassa negligentia imposed the lowest of the standards recognised by Holt CJ in Coggs. This became a common approach to honorary positions in the 19th century.").

120. *See generally* In re City Equitable Fire Insurance Co. [1925] Ch. 407.

121. *Id*. at 409–10.

122. *See* §215 of the Companies (Consolidation) Act 1908, 8 Edw. 7 c. 69 (U.K.). Today, the equivalent provisions are incorporated in §212–§213 of the Insolvency Act 1986 (fraudulent trading).

123. In re City [1925] Ch. at 436.

124. *Id*. at 428–29. *See also* Lagunas Nitrate Co versus Lagunas Syndicate [1899] 2 Ch. 392, 435 ("The inquiry, therefore, is reduced to want of care and bona fides with a view to the interests of the nitrate company. The amount of care to be taken is difficult to define; but it is plain that directors are not liable for all the mistakes they may make, although if they had taken more care they might have avoided them: see *Overend, Gurney & Co v Gibb*. Their negligence must be not the omission to take all possible care; it must be much more blameable than that: it must be in a business sense culpable or gross. I do not know how better to describe it.").

performance by failing directors.[125] In contrast to Delaware, the standard for breach of the duty of care under modern UK law has risen considerably and is no longer one of "gross negligence."[126] Furthermore, while in Delaware the business judgment rule is a fundamental concept of corporate law, it is not formally recognized in the UK's company law.[127] Despite this discrepancy between those legal systems, it was argued that UK courts traditionally refuse to impose liability on directors for honest mistakes of judgment similarly to the position of Delaware courts.[128]

A recent empirical study demonstrated that claimants have had success challenging business judgments in England and Wales dating from the mid-nineteenth century until the present, and that there has been a significant increase in personal liability since 2007.[129] Given there have been no pertinent changes in statutory law, this is likely the consequence of a greater willingness by claimants in insolvent companies to challenge directors' business judgment.[130] Therefore, the researchers particularly emphasized that the proposition that English courts will not review directors' business decisions, as is the norm in Delaware, is unfounded.[131] The study showed that challenges to business judgments were made and, following a court's review of directors' business judgment, liability was imposed in all the eras surveyed.[132] Moreover, it was found that liability was frequently imposed on the basis of flawed business judgment or the existence of conflicts of interest.[133] Lastly, while the study's observations mainly relate to litiga-

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125. KERSHAW, *supra* note 112, at 264 ("[A] strong consensus view was formed in commentary that the standard was weak and inappropriate for modern corporate conditions and, therefore, in need of reform to ensure that failing directors could be held to account and to deter poor performance.").

126. ASIC v Cassimatis (No 8) [2016] FCA 1023, [428] ("By the 1990s at the latest, the common law and equity had moved to a position where a director's duty to take care was one which was concerned with negligence, not gross negligence.").

127. Hill & Conaglen, *supra* note 110, at 325.

128. *Id*. at 324.

129. Andrew Keay, Joan Loughrey, Terry McNulty, Francris Okanigbuan, & Abigail Stewart, *Business Judgment and Director Accountability: A Study of Case-Law Over Time*, 20 J. CORP. L. STUD. 359, 359 (2020).

130. *Id*.

131. *Id*. at 386.

132. *Id*.

133. *Id*.

tion carried on directors of private and insolvent companies, directors of large public companies remain insulated from being held accountable by the English courts.[134]

*B. The Civil Law*

This section considers the civil law approach on directors' standard of care by discussing its versatility across different industries and how it takes a flexible approach according to the special features of the companies involved.

1. Germany

Under German law, the duty of care imposed on the directors obliges them to collect comprehensive information and to assess the risks and benefits for the company from a proposed transaction.[135] The company's interests are not limited to those of shareholders, and as they encompass the interests of creditors, employees, consumers, and society.[136] Engaging in risky actions is generally permitted as long as the expected gains balance such risks for the company.[137] In order to fulfill the standard of care, directors have to demonstrate that their business decision were based on adequate information for the best interest of the company.[138] Under § 93(1) of the Stock Company Act (AktG), the members of the management board have to employ the care of a diligent and conscientious manag-

134. *Id.*

135. Gudula Deipenbrock, *The 'Business Judgment Rule' and the Problem of Hindsight Bias – Observations from a German Company Law Perspective*, 27 EUR. BUS. L. REV. 197, 203–07 (2016).

136. Anja Tuschke & Marius Luber*, Corporate Governance in Germany: Converging Towards Shareholder Value-Orientation or Not So Much? in* THE CONVERGENCE OF CORPORATE GOVERNANCE: PROMISE AND PROSPECTS 75, 77 (Abdul A. Rasheed & Toru Yoshikawa eds., 2012). Recently, a major newspaper in Germany devoted an extensive article to discussing the history of stakeholders' approach in the country (including the period of 1933–1945) by comparing it to the American shareholder primacy model. *See* Franz W. Wagner, *Warum Manager lügen müssen*, FRANKFURTER ALLGEMEINE ZEITUNG (Oct. 3, 2020); https://www.faz.net/aktuell/wirtschaft/unternehmen/gastbeitrag-warum-manager-luegen-muessen-16984171.html. I thank my colleague Mr. Roland Kemper for bringing this article to my attention.

137. Aktiengesetz [AktG] [Stock Company Act], Sept. 6, 1965, BGB. I at 1089, last amendment in BGB I at 2586, July 23, 2013, §§ 93(1)-(2) (Ger.).

138. Gerhard Wagner, *Officers' and Directors' Liability Under German Law — A Potemkin Village*, 16 THEORETICAL INQUIRIES L. 69, 73–74 (2015).

er in connection with the management of the company. Germany incorporated the business judgment rule as a codified rule but has implemented it differently than Delaware law.[139] In Delaware law under the business judgment rule, the burden of proof is on the plaintiff to show that directors acted negligently, while in Germany, the burden of proof is on the directors to demonstrate their conduct was carried out with due care.[140]

German law provides that the duty of care is not uniform across industries, but adjusts to the specific situation for which the question of due care arises. Accordingly, the standard of due care is at the same time objective and relative; i.e., a company comparable in size, business, and economic situation will serve as a comparative model.[141] Thus, board members' duty of care cannot be measured against a uniform standard, since liabilities that fall on these individuals depend on their positions and knowledge base, as well as on the particularities of companies. Thus, rather than striving to articulate general key standards for an informed decision-making process which are applicable to all public companies across different industries, German law is designed to provide *firm-specific* standards of care following the special features of the corporations and markets. Consequently, it can be argued that what constitutes a care violation may be different from one company to another.[142]

2. France

In France, L225–251 of The Code de Commerce provides that a director or manager will be liable to the company "either for

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139. AktG § 93(1) cl. 2.

140. April 1997, BGHZ 135, 244 (ARAG/Garmenbeck); *see also* Aurelio Gurrea-Martínez, *Re-examining the Law and Economics of the Business Judgment Rule: Notes for its Implementation in Non-US Jurisdictions*, 18 J. CORP. L. STUD. 417, 420 (2018).

141. Deipenbrock, *supra* note 135, at 205; *see also* Robert J. Rhee, *The Tort Foundation of Duty of Care and Business Judgment*, 88 NOTRE DAME L. REV. 1139, 1143 (2013) (arguing that "Under the tort doctrine of industry customs, the scope of a director's duty of care reflects the implied standard of care that would be adopted by market participants.").

142. CARSTEN GERNER-BEUERLE & MICHAEL ANDERSON SCHILLIG, COMPARATIVE COMPANY LAW 508–509 (2019) ("On the other hand, what can be expected of a diligent and conscientious manager depends on the individual circumstances of the case, in particular the type of company and industry, the financial situation of the company, general market conditions, and the director's role within the company's governance structure.").

infringements of the laws or regulations applicable to public limited companies . . . or for breaches of the articles of association, or for management mistakes."[143] However, those provisions do not discuss the specific standard of care that directors and managers' conduct is subject to.[144] Although France did not adopt the business judgment rule explicitly, its courts are not likely to second-guess business decisions so long as the company does not become insolvent.[145] The law does not contain any definition of mismanagement or lack of due care, and the concept of negligence is highly fact-specific.[146] In addition, directors must exercise the care and diligence that can reasonably be expected from them in light of the circumstances of the case, including the director's role in the company and the nature of the company, i.e., whether it is a small family-owned business or a significant stock exchange-listed corporation.[147]

Moreover, director liability is determined according to the question of whether his conduct follows the interests of the company.[148] While the Anglo-American law adopts a narrow interpretation of a company's goal—focused exclusively on advancing the interests of shareholders—French law employs a relatively comprehensive understanding of the corporate interest.[149] Accordingly, companies are "considered as a separate economic agent, pursuing its own objectives which are distinct from those of shareholders, employees, creditors including the internal revenue authorities, suppliers and customers."[150] The interest of the company "represents the common interest of all of these persons, which is for the company to remain in business and prosper."[151] Thus, the French pluralistic understanding of company's goal provides directors with a substantially more flexible and wider scope of action than the one provided by the Anglo-American law. It enables directors to make deci-

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143. Rolf Dotevall, *Is a Common Structure of Company Directors' Duties Evolving in EU*?, 27 EURO. BUS. L. REV. 285, 289–90 (2016).

144. GERNER-BEUERLE & SCHILLIG, *supra* note 142, at 519.

145. *Id.* at 521.

146. *Id.* at 522.

147. *Id.*

148. *Id.* at 521–22.

149. THE BOARDS OF DIRECTORS OF LISTED COMPANIES IN FRANCE, CONSEIL NATIONAL DU PATRONAT FRANÇAIS & ASSOCIATION FRANÇAISE DES ENTERPRISES PRIVÉES 7 (1995).

150. GERNER-BEUERLE & SCHILLIG, *supra* note 142, at 52.

151. *Id.*

sions that may not necessarily align with the interests of shareholders but, nevertheless, are required to ensure the continuing existence of company, especially during difficult economic times.

### 3. Italy

Directors are subject to a duty of care when performing their responsibilities. They are required to satisfy the obligations provided by the law and by the articles of association with the diligence required by their office and their professional competence.[152] Similarly to France, the company's goal is perceived in broader terms, and as a result, directors are required to advance the interests of all stakeholders. Thus, directors may pursue objectives other than those of shareholders when it is in the best interest of the company as a separate business entity.[153] Italian law employs an objective standard of care alongside subjective elements.[154] Hence, Italian courts are required to consider directors' education and professional experience, as well as the company's dimension, type of business, and its complexity.[155] Italian law does not include any specific provision preventing judges from examining decisions made by directors retrospectively. However, the conventional understanding in Italy is that courts will not engage in a direct and substantive review of the business decision making process.[156] Thus, several Italian scholars argue that the national courts employ a robust version of the business judgment rule, which provides directors and managers with broad discretion when making business decisions.[157]

### 4. The Netherlands

Directors are required to meet the standard of care that can be expected of a director who is competent for his task and per-

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152. Art. 2392 Codice civile [C.c.] (It.).
153. Carlo Amatucci, *Directors' Duties in Italy*, in RESEARCH HANDBOOK ON DIRECTORS' DUTIES 141, 143 (Adolfo Paolini ed., 2014).
154. *Id.* at 145–46.
155. *Id.* at 145.
156. Guido Ferrarini, Gian Giacomo Peruzzo & Marta Roberti, *Corporate Boards in Italy*, *in* CORPORATE BOARDS IN LAW AND PRACTICE: A COMPARATIVE ANALYSIS IN EUROPE 369, 397–99 (Paul Davies, et al. eds., 2013).
157. *Id.* at 397; Amatucci, *supra* note 153, at 144–45.

forms his duties with diligence.[158] The statutory requirement to "properly perform" includes properly implementing the provisions of the law and the articles of association, as well as actions initiated by the shareholders.[159] There is no general standard similar to the business judgment rule. Courts generally do not second-guess actions that, under similar circumstances, could reasonably have been exercised by other, well-informed, and diligent executives in similar positions and types of industries or trades.[160] Therefore, courts consider all the circumstances of the case, including: the nature of the activities of the company; the risks which generally result from this type of activity; the division of tasks within the board of directors; and the knowledge that the director had or should have had at the time of the disputed action.[161] Moreover, the Netherlands applies the so-called "stakeholder model" as the leading concept underlying directors' duties.[162] As a consequence, a company director should at all times take due care of the company's interest in a rather broad sense, including shareholders', workers', creditors' interests, and even interests such as the environment and human rights.[163] This comprehensive understand-

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158. Arts. 2:9, 2:138, 2:149, 2:248, 2:259 BW (Neth.).

159. *See* STEVEN R. SCHUIT, CORPORATE LAW AND PRACTICE OF THE NETHERLANDS: LEGAL, WORKS COUNCILS AND TAXATION 176 (2002).

160. *Id.*

161. Iris S. Wuisman & Rogier A. Wolf, *Directors' and Officers' Liability in the Netherlands*, in DIRECTORS & OFFICERS LIABILITY, TORT AND INSURANCE LAW SERIES 295, 318 (Simon F. Deakin, Helmut Koziol & Olaf Riss, eds., 2018).

162. *See, e.g.*, Christiaan de Brauw, *The Dutch Stakeholder Experience*, HARV. L. SCH. F. CORP. GOV. (Aug. 2, 2020), https://corpgov.law.harvard.edu/2020/08/02/the-dutch-stakeholder-experience/.

163. The Dutch Corporate Governance Code states that the "management board should develop a view on long-term value creation" and "attention should [also] be paid to 'any other aspects relevant to the company and its affiliated enterprise, such as the environment, social and employee-related matters, the chain within which the enterprise operates, respect for human rights, and fighting corruption and bribery.'" *The Dutch Corporate Governance Code*, MONITORING COMMITTEE: CORP. GOV. CODE (Dec. 8, 2016), https://ecgi.global/sites/default/files/codes/documents/thenetherlands_cgcode_2016.pdf (last visited Feb. 8, 2020). *See also* Anne Lafarre & Christoph van der Elst, *Corporate Sustainability and Shareholder Activism in the Netherlands, in* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY 260, 263 (Beate Sjåfjell & Christopher Bruner eds., 2019).

ing of the company's goal enables directors to employ flexible discretion concerning the entity's strategy and policies, especially in challenging times during which the best interests of the company are more complicated than usual.

### *C. Further Thoughts*

While Anglo-American law provides a unified standard of care that is insensitive to the unique features across various industries, the civil law systems employ a flexible standard of care that is tailored to the company's functions and relevant characters of the markets. Since the civil law systems conceive of the best interests of the company in broader terms than the Anglo-American system, it provides directors with a larger expanse of discretion to handle the financial challenges associated with the global pandemic crisis. This observation is especially significant in times of financial distress when the conflict between shareholders and creditors is heightened. In particular, firms whose values barely exceed their debt increase the value of their shareholders' wealth if they take increased risks (including risks with negative expected returns), because if things go well, the profit goes to the shareholders, whereas if things go poorly, they lose no more than what they had already invested.[164] Creditors, however, can often be harmed by such conduct because it increases the likelihood that the firm will not be able to repay their debt, with no countervailing benefit if the risky action pays off since creditors' claims against the firm are fixed.[165] Therefore, providing directors with the ability to consider the best interests of the company as an independent legal entity, as in some of the civil law regimes noted above, that is distinct from shareholders' welfares enables companies to employ a wider range of measures to ensure their survival and future growth in this challenging financial period.

This broader range of available responses is particularly essential for SMEs that represent the core majority of businesses worldwide. According to the International Council for Small

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164. John Armour, Gerard Hertig, & Hideki Kanda, *Transactions with Creditors*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 111 (Reinier Kraakman ed., 2017).

165. For an illustration of this argument in economic modeling terms, *see* Vikas Mehrotra & Randall Morck, *Governance and Stakeholders*, *in* THE HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE 642 (Benjamin E. Hermalin & Michael S. Weisbach eds., 2017).

Business, micro-, small-, and medium-sized enterprises represent over 90% of all firms around the globe. Those firms provide almost 70% of the entire rate of global employment and more than 50% of the world GDP.[166] Also, SMEs are the backbone of Europe's economy as they represent 99% of all businesses in the EU.[167] In the past five years, they have created around 85% of new jobs and provided two-thirds of the total private sector employment in the EU.[168] Therefore, the rest of this piece is devoted to exploring the directors' duties of care in SMEs that are facing severe financial distress following the current catastrophic pandemic.

166. *Annual Global Micro-, Small and Medium-Sized Enterprises Report*, INT'L COUNCIL SMALL BUS. (2019), https://icsb.org/wp-content/uploads/2019/09/REPORT-2019.pdf.

167. ORG. FOR ECON. COOP. AND DEV., OECD, SME AND ENTREPRENEURSHIP OUTLOOK 2019 36–38 (2019).

168. The Commission Recommendations of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises define SMEs according to staff headcount and either turnover or balance sheet total, as demonstrated in the following chart:

| Company category | Staff headcount | Turnover | or | Balance sheet total |
|---|---|---|---|---|
| Medium-sized | < 250 | ≤ € 50 m | | ≤ € 43 m |
| Small | < 50 | ≤ € 10 m | | ≤ € 10 m |
| Micro | < 10 | ≤ € 2 m | | ≤ € 2 m |

Source: The Commission of the European Union; https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:124:0036:0041:en:PDF.

In the USA, the definition of SMEs is based on the position of the entity in the overall marketplace. Section § 203 to the Small Business Act 1953 (15 U.S.C. chapter 14A.) (SBA) states: "[F]or the purposes of this Act, a small-business concern, including but not limited to enterprises that are engaged in the business of production of food and fiber, ranching and raising of livestock, aquaculture, and all other farming and agricultural related industries, shall be deemed to be one which is independently owned and operated and *which is not dominant in its field of* operation." Small Business Act, Pub. L. No. 83-163, § 203, 67 Stat. 230 (1953). The SBA employs different economic factors, such as each industry's overall competitiveness and the competitiveness of firms within each industry, to determine its size standards. *See also Size Standards Methodology White Paper*, U.S. SMALL BUS. ADMIN. (Apr. 11, 2019), https://www.sba.gov/document/support—size-standards-methodology-white-paper. *See generally*, ROBERT JAY DILGER, CONG. RSCH. SERV., R40860, SMALL BUSINESS SIZE STANDARDS: A HISTORICAL ANALYSIS OF CONTEMPORARY ISSUES (2020).

## III. UNDERSTANDING DIRECTORS' ROLE AND DUTIES IN SMEs IN TIMES OF BUSINESS DISTRESS

This Part is devoted to exploring directors' roles in different types of SMEs and explaining why the civil law provides boards with a broader scope of discretion required to confront companies' financial distress in the era of a global pandemic.

### *A. The Core Argument*

Although SMEs play a significant role in the global business sector, comparative corporate law is mostly concerned with regulating the relationship between insiders and outsiders in the context of large public companies. Thus, jurists and policymakers have given much less attention to constructing appropriate arrangements for governing the conduct of SMEs' organs.[169] Since a significant volume of companies around the world are small firms involved in small-scale manufacturing and provision of services, concentrating only on boards in large publicly held companies, narrows the understanding of the role and contribution of boards in other contexts—such as start-ups, family businesses, or fast-growing entrepreneurial ventures and partnerships.[170] Arguably, SMEs need their boards of directors to play differing roles than those of large public corporations. For example, empirical studies show that SMEs typically have few owners and often feature an overlap between ownership and management.[171] Shareholders are often employed in the company, and they have long-term and close connections with each other through family connections.[172] It can be argued that to some extent in SMEs, the advisory function

169. Carlos Gorriz, *EU Company Law: Past, Present and…Future?*, GLOBAL JURIST 1, 14 (2018) ("[T]he focus must continue on the needs of the enterprises; of all types of enterprises. It is important to pay attention to SMEs, because their necessities have been neglected.").

170. Jonas Gabrielsson & Morten Huse, *"Outside" Directors in SME Boards: A Call for Theoretical Reflections,* 1 CORP. BOARD: ROLE, DUTIES AND COMPOSITION 28, 30 (2005).

171. Mette Neville, *The Many Roles of Boards of SMEs*, *in* BOARDS OF DIRECTORS IN EUROPEAN COMPANIES: RESHAPING AND HARMONISING THEIR ORGANISATION AND DUTIES 179 (Hanne S. Birkmose et al., 2013).

172. Qiang Cheng, *Family Firm Research – A Review*, 7 CHINA J. ACCT. RES. 149, 150 (2014) ("family owners have longer investment horizons than other shareholders. They generally regard their ownership as an asset to pass on to future generations . . . family members are actively involved in the management of their firms, either as top executives or as directors").

of the board is substantially more important than its monitoring function.[173] The nexus between shareholders and managers observed in such firms is a natural hindrance to emergence of opportunistic behavior manifested in publicly held companies, and consequently reduces monitoring costs.[174] These agency costs are not unheard of, however, and they often arise in the context of venture capital investors that obtain funds from individual investors in exchange of various controlling and equity rights.[175]

Nevertheless, given the emphasis on the advisory role of SMEs' directors, it is disputable whether the current law on directors' duty of care in different countries allows them sufficient breadth of conduct in times of financial distress. Civil law rather than Anglo-American law provides directors with better means to preserve companies' solvency in periods of financial crisis. Under civil law, the directors' general duty of care towards the corporation can be construed so as to encompass the stakeholders' interests in preserving the assets and solvency of the corporation.[176] For instance, in the Netherlands, directors are required to act in the best interest of the company and its enterprise, and it is perceived to include all relevant stakeholders.[177] The Dutch Supreme Court also confirmed that shareholder interests "do not take priority over the interests of other

173. Neville, *supra* note 171, at 185.

174. Eli Bukspan & Eylon Yadin, *Marrying Corporate Law and Family Businesses*, 66 DRAKE L. REV. 550, 558 (2018) ("The controlling family often places family members and close associates in senior managerial positions or ensures family members are significantly represented on the board of directors and various supervisory committees. Consequently, family and senior officers acting on behalf of the shareholders share the same interests; hence, there are little to no conflicts of interest between owners and management"). *See generally* Marcelo Godke Veiga & Joseph A. McCahery, *A Theory of SME Governance Regulation*, 78 REVISTA DE DIREITO BANCARIO E DO MERCADO DE CAPITAIS 1 (2017) who propose to create an analytical framework of the promulgation of rules regulating SMEs that will be used based on technical rationals.

175. Veiga & McCahery, *supra* note 174, at 24.

176. GREGOR BACHMANN, HORST EIDENMLLER, ANDREAS ENGERT, HOLGER FLEISCHER, WOLFGANG SCHN., REGULATING THE CLOSED CORPORATION 101–04 (2014).

177. *See generally* Beate Sjafjell, Andrew Johnston, Linn Anker-Sørensen, & David Millon., *Shareholder Primacy: The Main Barrier to Sustainable Companies*, *in* COMPANY LAW AND SUSTAINABILITY (Beate Sjafjell et al. eds., 2015).

stakeholders."[178] In a similar vein, France's new PACTE Law enshrines a principle that was previously developed in French case law by adding the following provision to Article 1833 of the Civil Code: "[t]he company is managed in its corporate interest . . ." and it must take into consideration "the social and environmental issues related to its activity."[179] Accordingly, the new PACTE Law encourages socially responsible business by creating "mission businesses" (entreprises à mission): commercial companies that have, as their purpose, the pursuit of social and environmental objectives.[180]

In contrast, the jurisprudence of the Delaware courts opposes such concepts and insists that a board member's duties are directed exclusively to protect shareholders' interests.[181] Broader interests can be considered only when the corporation is insolvent.[182] Similarly, UK law provides that only in the vicinity of insolvency are directors required to act in the interest of the

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178. *See generally id.*

179. Blanche Segrestin, Armand Hatchuel, & Kevin Levillain, *When the Law Distinguishes Between the Enterprise and the Corporation: The Case of the New French Law on Corporate Purpose*, (unpublished article) (on file with J. BUS. ETHICS).

This notion is similar to the Benefit Corporations model which has now been written into the laws of thirty three American states. See Mark J. Loewenstein, Benefit Corporation Law, 85 U. Cin. L. Rev. 381, 383 (2017).

181. Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance,* CORNELL L. REV. (forthcoming Dec. 2020) (arguing that stakeholderism could impose substantial costs on shareholders, stakeholders, and society at large and reduce corporate leaders' accountability).

182. N. Am. Catholic Educ. Programming Found. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) ("When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners."); Prod. Res. Group v. NCT Group, 863 A.2d 772, 787–89 (Del. Ch. 2004). For a similar position in the UK, *see* BTI 2014 LLC v. Sequana S.A. [2019] EWCA (Civ) 112 [198] ("[T]he interests of creditors are identified as interests different from, and potentially in conflict with, the promotion of the success of the company for the benefit of its members as a whole."). *See also* Brad Eric Scheler, Gary L. Kaplan, Jennifer L. Rodburg, & Fried, Frank, Harris, Shriver & Jacobson LLP, *Director Fiduciary Duty in Insolvency*, HARV. L. SCH. F. CORP. GOVERNANCE (Apr. 15, 2020), https://corpgov.law.harvard.edu/2020/04/15/director-fiduciary-duty-in-insolvency/.

creditors "as a whole" rather than those of shareholders.[183] Creditor-oriented duties in this stage of the firm lifecycle may deter directors from placing assets in "high-risk, high-reward" projects even though shareholders may support these strategies since their risk preferences have changed.[184] The same explanation has been proposed to justify the wrongful trading rule, which exposes directors of companies in liquidation or administration to personal liability when they should have known that there was no reasonable prospect of the company avoiding insolvent liquidation and failed to employ "every step with a view to minimizing the potential loss to the company's creditors."[185]

The sharp distinction between the preference given to shareholders' interests when the company is solvent and the preference given to creditors' interests when the company is insolvent does not provide directors with the necessary scope of discretion needed to stave off insolvency when adopting policies that

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183. Companies Act 2006, c. 46, § 172(3) (UK); Colin Gwyer v. London Wharf (Limehouse) Ltd [2002] EWHC (Ch) 2748 [906] (Eng.).

184. Kristin van Zwieten, *Director Liability in Insolvency and Its Vicinity*, 38(2) OXFORD J. LEGAL STUD. 382, 388 (2018).

185. Insolvency Act 1986, c. 45 §§ 214 (liquidation), 246ZB (administration) (UK). It should be noted that similar care duties also exist in EU countries. *See* Directive 2019/1023, of the European Parliament and of the Council of 20 June 2019 on Preventive Restructuring Frameworks, on Discharge of Debt and Disqualifications, and on Measures to Increase the Efficiency of Procedures Concerning Restructuring, Insolvency and Discharge of Debt, and Amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency), 2019 O.J. (L 172) 18, 19. *See also* Directive 2017/1132, of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification), 2017 O.J. (L 169) 46. Following the COVID-19 outbreak, the Executive of the Conference on European Restructuring and Insolvency Law suggested that such duties should be suspended because the current economic uncertainty hampers the effectiveness of this duty which is aimed at selecting non-viable businesses. *See generally* STEPHAN MADAUS & BOB WESSELS, CERIL EXECUTIVE STATEMENT 2020-1 ON COVID-19 AND INSOLVENCY LEGISLATION (2020). Several countries, such as Germany, Spain and Italy followed that recommendation. *See* Gert-Jan Boon, *COVID-19 Crisis Requires Legislators to Adapt Insolvency Legislation*, OXFORD BUS. L. BLOG (Mar. 27, 2020), https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/covid-19-crisis-requires-legislators-adapt-insolvency-legislation; Aurelio Gurrea Martínez, *Directors' Duties of Financially Distressed Companies in the Time of COVID-19*, OXFORD BUS. L. BLOG (Mar. 24, 2020), https://www.law.ox.ac.uk/business-law-blog/blog/2020/03/directors-duties-financially-distressed-companies-time-covid-19.

pursue objectives other than the shareholders' interests. The reticence to impose liability found in the Anglo-American regimes may, in some circumstances, incentivize directors to initiate insolvency proceedings even when an out-of-court restructuring attempt would be preferable and increase overall welfare. Moreover, those regimes raise special difficulties, such as identifying when exactly the shift in the objective of duty of care occurred.[186] These difficulties are relevant to a much lesser extent in civil law systems because those legal regimes provide more nuanced arrangements to directors' duty of care. Such arrangements enable directors to implement a custodial approach, which focuses on protecting the company's assets by readopting an entrepreneurial strategy when possible, without worrying that wrongful trading liability will be imposed on them.[187]

Furthermore, since directors' duty of care in civil law systems follow firm-specific standards and the distinctive features of industries and markets, it provides a more flexible framework for promoting risk-taking, incentivizing business investment, and reducing information gaps in times of financial distress. For instance, a recent decision by the Dutch Supreme Court in 2014—*A v. Cancun Holding I*—indicates that the legal duties of directors should be interpreted as following the organizational characteristics of an individual company.[188] The facts of this case are as follows: Cancun Holding II had been established in August 2005 by Cancun Holding I to develop a hotel complex in the Mexican city of Cancun through its subsidiary

186. Andrew R. Keay, *The Shifting of Directors' Duties in the Vicinity of Insolvency*, 24(2) INT'L INSOLVENCY REV. 140, 151 (2015).

187. *Id.* at 150–51; ANDREW R. KEAY, THE CORPORATE OBJECTIVE 306 (2011) ("The directors can be seen as the 'custodians of the enterprise objectives of survival and growth.'"). *See also* Amir Licht, *What's so Wrong with Wrongful Trading?—on Suspending Director Liability during the Coronavirus Crisis,* OXFORD BUS. L. BLOG (Apr. 9, 2020), https://www.law.ox.ac.uk/business-law-blog/blog/2020/04/whats-so-wrong-wrongful-trading-suspending-director-liability-during.

188. HR 4 April 2014, NJ 2014, 286 m.nt. P. van Schilfgaarde (A/Cancun Holding I) (Neth.) (translation by author) [hereinafter A/Cancun Holding I]; HR 4 April 2014, RvdW 2014, 557 m.nt. (TMF Netherlands BV/Cancun Holding I) (Neth.) (translation by author); HR 4 april 2014, RvdW 2014, 558 m.nt. (Inversiones/Cancun Holding I) (Neth.) (translation by author); HR 4 April 2014, RvdW 2014, 556 m.nt. (Invernostra SL/Cancun Holding I) (Neth.) (translation by author).

entity, Efesyde SA de CV.[189] In October 2006, Cancun Holding I transferred 50% of its shares of Cancun Holding II to Inversiones Ma y Mo SL (Inversiones).[190] On June 2009, Invernostra SL (Invernostra) acquired 7% of the shares of Cancun Holding II.[191] During 2008, disputes arose between Cancun Holding I and Inversiones about the costs associated with building and operating the hotel complex.[192] The shares that Cancun Holding I held in Cancun Holding II were "A-shares"; the stocks that Inversiones held in Cancun Holding II were "B-shares"; and the shares that Invernostra owned in Cancun Holding II were "C-shares."[193] The articles of association posited that the owners of A, B and C shares held the right to nominate managing directors of Cancun Holding II.[194] During 2009, the board of Cancun Holding II suggested that Cancun Holding II issues shares to Inversiones and Invernostra—but not to Cancun Holding I.[195] The proposal would eventually dilute the holdings of Cancun Holding I from 22% to 0.13%.[196] Cancun Holding I opposed the proposal and did not attend the general meeting that would decide whether to issue the shares.[197] As a result, the shares could not be issued because, under the articles of association, a resolution to issue shares required the participation of all shareholders and a unanimous vote.[198] Nevertheless, the articles allowed for a second general meeting to be convened where a resolution to issue shares could be executed notwithstanding the number of participant shareholders and by a simple majority.[199] In accordance with the articles, the notice announcing this meeting was published in a local Mexican

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189. A/Cancun Holding I para. 3.1(i) (translation by author).

190. *Id.* para. 3.1(ii) (translation by author).

191. *Id.* para. 3.1(iii) (translation by author).

192. *Id.* para. (xi) (taken from the appeals record included in this case) (translation by author).

193. *See id.* para. 3.1(iii) (translation by author).

194. *Id.* para. (xvii) n.1 (taken from the appeals record included in this case) (translation by author).

195. *Id.* para. (xxii) n. 1 (taken from the appeals record included in this case) (translation by author).

196. *Id.* para. 3.1(xii) (translation by author).

197. *Id.* para. (xxiv) (taken from the appeals record included in this case) (translation by author).

198. *See id.* para. (xxii) (taken from the appeals record included in this case) (translation by author).

199. *See id.* para. (xxiv) (taken from the appeals record included in this case) (translation by author).

newspaper.[200] Cancun Holding I was not represented in this general meeting because it was not aware of it.[201] In the proceedings initiated by Cancun Holding I against Cancun Holding II, the Enterprise Court approved the request of Cancun Holding I that an independent investigation be conducted into the course of affairs of Cancun Holding II.[202] In April 2014, the Dutch Supreme Court revoked these appeals and explained that if the company carries on as an enterprise, the interests of the company will be furthered by promoting the lasting success of that enterprise and preserving the company's other organizational characteristics.[203] The Court ruled that in a joint venture, the type and content of the agreement between shareholders determines the corporate interests and will seek to create a balanced and stable relationship between shareholders.[204] Accordingly, the duty of corporate directors is guided by the best interests of the company and the undertaking the company pursues.[205] Thus, directors should consider the project that is connected with the company's business as well as other organizational characteristics to understand the content of their duties.[206] In the *Cancun* case, the firm was a joint venture company in which the shareholders were, and were intended to remain, equal.[207] In different cases, however, "other organizational characteristics may be relevant: e.g. that the company is the parent company of a group, that the company is a subsidiary company in a group, that the company has only one shareholder or that the company is a family business."[208]

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200. *Id.* para. 3.1(xii) (translation by author).

201. *Id.* para. 3.4.5 (translation by author).

202. *See id.* para. 3.2 (translation by author).

203. Cornelis de Groot, *Some Observations on the Nature of the Company, Especially Against the Backdrop of the Duty of Directors to be Guided by its best Interests*, *in* CORE CONCEPTS IN THE DUTCH CIVIL CODE: CONTINUOUSLY IN MOTION 187, 207–09 (C.G. Breedveld-de Voogd et al. eds., 2016).

204. *See* Martin Gelter, Nemika Jha & D. Gordon Smith, *Duties of Nominee Directors*, *in* COMPARATIVE COMPANY LAW A CASE-BASED APPROACH 73, 93–94 (Mathias Siems & David Cabrelli eds., 2018).

205. *See id.* at 93.

206. *Id.* at 94.

207. *Id.* ("In the Cancun case there was, in short, a shareholder agreement on the basis of which shareholders had agreed to collaborate in the joint venture on the basis of equality.").

208. Groot, *supra* note 203, at 209.

Another instructive example is the Swedish Supreme Court's ruling concerning the limits of board responsibility for not submitting the necessary financial reports to the general meeting of shareholders in times of financial distress.[209] In this case, the Court considered whether individuals who joined the board of directors in the period of the company's statutory duty should incur the same liability as other members who have served on the board for a long period.[210] The Court ruled that the liability assessment should focus on whether the director acts in a way that is in accordance with the company's current situation and "a newly appointed board member cannot be assessed according to the same standard as the one who has a long time behind him on the board."[211] Therefore, the Court posits that the law should not require newly appointed board member be fully acquainted with the company's conditions from day one, and "a time limit for the member to familiarize himself with these must be accepted."[212] Moreover, the Court expressed the view that the liability assessment should focus on whether the director acts in a way that is in accordance with the company's current situation,[213] and director business judgment should be reviewed more freely if a company is struggling with severe economic difficulties.[214] As was clarified by the Court:

> The negligence test should not focus on questions of admissibility but on whether the board member concerned has acted responsibly in the specific situation in which the company was. In the frame of court's ex post-assessments, a relatively generous and understanding view of what should have been done and not done will be carried out. As long as the board member has met reasonable requirements when it comes to staying informed and making a serious evaluation of the situation, there is rarely a reason to question the conclusions the board member has reached.[215]

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209. Nytt Juridiskt Arkiv [NJA][Supreme Court Reports] 2012 p. 858 T 5779-10 (Swed.) (translation by author).
210. *See id.* para. 11 (translation by author).
211. *Id.* para. 21 (translation by author).
212. *Id.* para. 23 (translation by author).
213. *See id.* paras. 21–22 (translation by author).
214. *Id.* para. 22 (translation by author).
215. *Id.* (translation by author).

### *B. Directors' Roles in Family Business in Period of Financial Crisis*

This section draws distinctions between two types of SMEs, family businesses and venture capital-backed firms, and discusses boards' roles in confronting the consequences of the global epidemic situation.[216] Family companies have several unique features that provide them with an advantage over non-family companies: long-term vision; matching interests between owners, management, employees, and the company; and a correlation between the reputation and public image of the family and the company.[217] Generally, these firms adopt a business approach that encourages long-term perspectives over short-term profits.[218] Studies have shown that family firms are more risk averse than non-family firms, invest in safer research and development projects, and carry lower levels of debt in an effort to prepare for potential future periods of financial distress.[219] This long-term business vision causes family firms to reinforce relations with various financial providers, such as creditors, suppliers, banks, and other claimants.[220] Although the literature on boards' roles has focused on family-firm directors' monitoring role, it must be noted that the board also makes significant contributions as an adviser and provider of valuable resources, especially in times of crisis.[221]

The director's advisory role is reflected in two main board tasks. First, the resource-based approach posits that directors provide professional competencies, skills and experiences to family businesses.[222] They complement the management team's knowledge base, especially when there is a "lack [in] internal

216. Gabrielsson & Huse, *supra* note 170, at 31–34.

217. Bukspan & Yadin, *supra* note 174, at 563–65.

218. *Id.*

219. Martin R. W. Hiebl, *Risk Aversion in Family Firms: What do we really know?,* 14(1) JOURNAL OF RISK FINANCE 49, 56–57 (2013).

220. Bukspan & Yadin, *supra* note 174, at 558–59.

221. Julio Pindado & Ignacio Requejo, *Family Business Performance from a Governance Perspective: A Review of Empirical Research*, 17 INTERNATIONAL JOURNAL OF MANAGEMENT REVIEWS 279, 292 (2015).

222. *See* Jefferey Pfeffer, *Size and Composition of Corporate Boards of Directors: The Organization and its Environment*, 17 ADMIN. SCI. Q. 218, 219 (1972) (considering the "use of the board of directors as a vehicle for dealing with problems of external interdependence and uncertainty, resulting from its exchange of resources with important external organization.").

resources and expertise to pursue growth."[223] Second, the resource-dependent approach posits that directors provide access to critical external stakeholders by linking the firm to its external environment.[224] Formation of alliances by securing good relationships with other stakeholders is especially necessary to overcome family firms' general resource-scarcity.[225] When faced with cash-flow problems and loss of reputation in times of crisis, directors can activate their external networks in search of relief. In such cases, directors can attract additional equity providers who can improve the financial condition of the firm.[226] Moreover, in the period of financial distress, directors can communicate the company's unique family values to various stakeholders and recruit them to contribute essential resources required to the firm's survival.

Another study examined the main factors that contribute to the survival of family firms in periods of financial crisis.[227] Several attributes of board of directors are significant in determining whether the company will survive in financially difficult times. Attributes like size, age and experience of directors, gender diversity, director location, and directors' personal networks have been shown to relate to lower bankruptcy risk.[228] Also, board members who already have experience with crises management better understand the challenges the family firm is facing and can employ that experience to mitigate the bankruptcy risk.[229] In contrast, board instability as reflected in resignations from the board in a given year and previous failure

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223. Yannick Bammens, Wim Voordeckers & Anita Van Gils, *Boards of Directors in Family Businesses: A Literature Review and Research Agenda*, 13 INTERNATIONAL JOURNAL OF MANAGEMENT REVIEWS 134, 141 (2011).

224. Fynn-Willem Lohe & Andrea Calabrò, *Please Do Not Disturb! Differentiating Board Tasks in Family and Non-Family Firms During Financial Distress*, 33 SCANDINAVIAN JOURNAL OF MANAGEMENT 36, 38–39 (2017).

225. Sabine B. Rau, *Resource-Based View of Family Firms*, *in* THE SAGE HANDBOOK OF FAMILY BUSINESS 321, 331 (Leif Melin, Mattias Nordqvist & Pramodita Sharma eds., 2014).

226. Lohe & Calabrò, *supra* note 224, at 40.

227. Nick Wilson, Mike Wright & Louise Scholes, *Family Business Survival and the Role of Boards*, 37(6) ENTREPRENEURSHIP THEORY AND PRACTICE 1369 (2013).

228. *Id.* at 1369–70.

229. *Id.* at 1383.

experiences of board members are associated with higher bankruptcy risk.[230]

When assessing the conduct of a family firms' directors, particular attention should be paid to certain features of the firm, namely, the socio-emotional wealth associated with controlling the family business.[231] First, while most studies find that family firms are more risk-averse than non-family firms, this attitude may change for larger, financially distressed family companies that compare in size to large public corporations.[232] In such cases, there is a higher tendency for the controlling family to take risks at the expense of other stakeholders, such as creditors and employees.[233] Second, the amount of risk a family firm takes on "strongly depends on the situation of the family firm . . . ."[234] When the family owners fear losing control of the firm, they may choose to engage in riskier ventures than non-family firms.[235] In that case, there is a concern that the family will employ every means available to save the socio-emotional wealth associated with controlling a firm, even if such actions include inflicting substantial risks on stakeholders.[236]

In these circumstances, civil law, rather than Anglo-American law, provides a better systematic framework for directors to promote the best interests of the *company* rather than those of the controlling shareholders. This also applies to

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230. *Id.*

231. *See* L.R. Gómez-Mejía, Katalin Takács, Manuel Núñez-Nickel, Kathyrn J. L. Jacobson, & José Moyano-Fuentes, *Socioemotional Wealth and Business Risks in Family-Controlled Firms: Evidence from Spanish Olive Oil Mill*, 52(1) ADMINISTRATIVE SCIENCE QUARTERLY 106, 106 (2007) (According to the socio-emotional wealth, the owner of a family firm derives a non-financial/non-economical value from its owning and controlling position in the firm, such as "identity, the ability to exercise family influence, and the perpetuation of the family dynasty.").

232. Hiebl, *supra* note 219, at 62.

233. *Id.* at 62–63.

234. *Id.* at 49.

235. *See id.*

236. Gómez-Mejía, Takács, Núñez-Nickel, Jacobson & Moyano-Fuentes*, supra* note 231, at 129 ("We have shown that when family firms are faced with a strategic choice dilemma that involves (1) a high degree of certainty of improved financial gains and a better probability of survival, but loss of family control (i.e., joining the coop), and (2) a greater risk of declining performance and catastrophic business failure, but retention of family control (i.e., choosing to remain independent and not join the coop), the clear winner is the "risk willing" decision.").

board members who were appointed by a significant individual shareholder, since a close connection between a director and a major shareholder may undermine the traditional principle of equality between shareholders in civil company law.[237] This civil law determination conflicts with the position of UK law, which generally provides that directors owe fiduciary duties to the company as a whole, but also allows for certain circumstances in which directors will owe specific responsibilities to individual shareholders.[238] In such cases, individual shareholders may bring a direct action, as distinct from a derivative action, against the directors for breach of fiduciary duty.[239]

A recent English case, *Vald Nielsen Holding A/S v Baldorino* considered the following facts: The management team of a company called Updata Infrastructure (UK) Ltd (the Target) launched a management buy-out with the support of a private equity house.[240] Following a bidding process, the entire issued share capital of the Target was bought by a new company (Newco), in which the management team had significant stakes.[241] In the stage of the bidding process, the controlling shareholders in the Target had concluded that the offer presented by the management teams was more attractive than the offer made by a rival bid.[242] Nevertheless, several shareholders believed that they were misled by false representations by the management team about the Target's financial condition and the proceedings received were significantly less than the true value of the shares.[243] Thus, shareholders argued that they are entitled to recover an account of profits as a result of the management team's breach of fiduciary duties directed to protect their special interests.[244] The court examined English, Australian, and New Zealand case law and decided that, while as general rule directors do not owe fiduciary duties to their shareholders, the rule is subject to a caveat which revolves around

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237. Gudmund Knudsen & Harald Norvik, *Corporate Governance in Norway*, *in* THE NORDIC CORPORATE GOVERNANCE MODEL 201, 228 (Per Lekvall ed., 2014).

238. Peskin v. Anderson [2001] BCC 87, para. 31.

239. *Id.* para. 31–34.

240. Vald Nielsen Holding A/S v Baldorino [2019] EWHC 1926 (Comm) [para 1–3].

241. *Id.* para. 3.

242. *Id.*

243. *Id.* para. 1–15.

244. *Id.* para. 14.

the nature of the relationship between directors and shareholders.[245] The judge accepted that a director acquiring shares from a shareholder does not of and in itself create a fiduciary duty.[246] The existence of such duty depends upon the relationship between the directors and the affected shareholders and the mere fact that a director had knowledge of the company's affairs does not itself give rise to exceptional circumstances.[247] The court further stated these special circumstances are more likely to arise when the shareholder is an owner of a family firm, indicating a special relationship between this shareholder and directors.[248] This last observation is misplaced because such a unique connection between shareholder and director can be used, in certain circumstances, against the best independent interests of the company. This is especially prevalent in situations where the family firm is in a severe economic crisis, and there is a particular concern from losing the socio-emotional wealth associated with control.[249] The significant hazard from externalizing risks on creditors to ensure continued control may justify the adoption of the civil law approach rather than the UK approach for adequately ensuring the continuing survival of the company.

### *C. Directors' Roles in Venture Capital-Backed Firms in Period of Financial Crisis*

Typical descriptions of corporate governance focus on shareholder-manager conflicts or potential controlling shareholder opportunism towards minority shareholders. These descriptions do not adequately describe the operations of startups that involve participants who often hold overlapping and shifting roles.[250] As an example, consider a venture capitalist (VC) in-

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245. *Id.* para. 722–23.
246. *Id.* para. 745.
247. *Id.* para. 744.
248. *Id.* para. 725.
249. Gómez-Mejía, Takács, Núñez-Nickel, Jacobson & Moyano-Fuentes, *supra* note 231, at 107 ("Family firms may be willing to incur a greater performance hazard, as evidenced by a greater probability of failure and below-target performance, if this is what it takes to protect their socioemotional wealth. Hence, they are loss averse when it comes to threats to their socio-emotional wealth (relinquishing family control) even if this means accepting a greater performance hazard.").
250. Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 159–61 (2019).

vestor with a seat on the board of a startup. The investor holds dual status as principal in one context and agent in another. The resource-dependent view posits that VC investors and founders collaborate to seek mutual gain while being dependent on each other's contribution.[251] Entrepreneurs require capital injection for growth, and typically have limited sources to raise that capital because they are private firms with a high risk of failure[252] Although VC investors are generally less dependent on the entrepreneur because they manage a portfolio of entrepreneurial firms,[253] they generally inject capital only when they identify outstanding managerial capabilities that can increase firm performance.[254] Typically, startups have multiple classes of stock consisting of preferred stock held by VC investors and common stock held by founders and company employees.[255] These classes create a capital structure that gives rise to a significant and complicated conflict of interests between different groups of shareholders concerning the control of the firm.[256] As a startup matures, participants' roles expand in managing the firm's operation and they may hold varied interests and claims affecting firm's governance.[257]

The conflict between VC investors and entrepreneurs in a period of financial distress was recently illustrated in the Delaware case, *In re Trado*.[258] Tradros faced financial difficulties when a potential purchaser emerged, and the board decided to sell the corporation at a deal price almost equal to the preferred liquidation preference.[259] The merger consideration satis-

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251. Andrew Zacharakis, Truls Erikson & Bradley George, *Conflict Between the VC and Entrepreneur: The Entrepreneur's Perspective*, 12(2) VENTURE CAP. 109, 111–12 (2010).

252. *Id.* at 111.

253. *Id.* at 111–12.

254. *See* Bob Zider, *How Venture Capital Works*, HARV. BUS. REV. https://hbr.org/1998/11/how-venture-capital-works ("During this adolescent period of high and accelerating growth, it can be extremely hard to distinguish the eventual winners from the losers because their financial performance and growth rates look strikingly similar . . . At this stage, all companies are struggling to deliver products to a product-starved market. Thus the critical challenge for the venture capitalist is to identify competent management that can execute – that is, supply the growing demand.").

255. Pollman, *supra* note 250, at 170–76.

256. *Id.* at 176–96.

257. *Id.* at 196–200.

258. *See generally* In re Trados S'holder Litig., 73 A.3d 17 (Del. Ch. 2013).

259. *Id.* at 33.

fied nearly all the preferred liquidation preference and left no yields for the common stock.[260] The board of directors' decision to sell the corporation was challenged by a stockholder who owned 5% of the corporation's common stock.[261] Although the Delaware Court of Chancery found that common stockholders in Trados as a going concern were unharmed,[262] it emphasized that the board does not owe fiduciary duties to preferred stockholders and should consider the interests of common stockholders solely as "residual claimants."[263] The interests of preferred stockholders should be taken into consideration only to the extent that they do not invoke their exclusive contractual rights.[264] The Chancery Court acknowledged the heterogeneity on the board, which is reflected in directors acting as "dual fiduciaries"—i.e., they have fiduciary duties to the venture fund itself, as well as to the stockholders of the company on whose board they serve.[265] Importantly, the court applied the same set of fiduciary duties to all directors across the board—including those from the VC firm that held preferred stock.[266] Accordingly, directors are obligated to identify and advance the *shared interest* of preferred and common stockholders. This guideline proves problematic when preferred and common stockholders firmly disagree over which course of action promotes the position of "stockholders in the aggregate."[267] In addition, since the court identified the overall benefit of the company with advancing the interests of the common stockholders solely, it did not

260. *Id.*
261. *Id.* at 34–35.
262. *Id.* at 76.
263. *Id.* at 41–42.
264. *Id.* at 39–40.
265. Steven E. Boschner & Amy L. Simmerman, *The Venture Capital Board Member's Survival Guide: Handling Conflicts Effectively While Wearing Two Hats*, 41 DEL. J. CORP. L. 1, 4–10 (2016); Martin Gelter & Geneviève Helleringer, *Lift Not the Painted Veil! To Whom Are Directors' Duties Really Owed?,* 2015 U. ILL. L. REV. 1069, 1075 (2015) (arguing that under conditions of boards' heterogeneity "[t]he content of the corporate objective and of the fiduciary duties is indirectly determined (1) by the factors that influence the appointment of directors and the pressure on information sharing that derives thereof, which is how constituency directors deal with their sponsors with respect to information; and (2) social, cultural, and economic factors that determine how directors come to their decisions.").
266. In re Trados S'holder Litig., at 40–42.
267. *See, e.g.*, Fredrick Hsu Living Trust v. ODN Holding Corp et al. 2017 WL 1437308, at 17 (Del. Ch. Apr. 14, 2017).

consider any other stakeholders interests that surely would have been affected by such determination.

Moreover, in times of financial distress, the conflict between VC investors and entrepreneurs may manifest in other aspects of strategic decision-making, such as research and development (R&D) activities and marketing schedules.[268] Naturally, any strategy that will be chosen by the board of directors has significant implications on the welfare and attitude of other stakeholders involved in the company's business, such as creditors, suppliers, consumers, and employees. Therefore, several commentators argue that to mitigate the horizontal conflicts of interest, the board of directors should employ a duty of impartiality.[269] This duty involves considering the different interests of the beneficiaries honestly and balancing them in a manner in accordance with the beneficial interests and the terms and purposes of the company.[270] Accordingly, in times of financial distress, directors have to fairly, rather than equally, assess the divergent demands of stakeholders and ensure that adopting individual strategy will not disproportionately externalize risks on any specific constituency or involve opportunistic behavior by a particular stakeholder.

The civil law concerning a director's fiduciary duties provides a more fertile ground for adopting the fiduciary duty of impartiality than the Anglo-American law. As shown above, civil law views the corporation's benefits as comprised of all the stakeholders' interests who are involved in the firm's operations and rejects the idea that corporation's benefit should be solely identified with advancing the welfare of shareholders. For instance, in the *Cancun* case, the Dutch Supreme Court held that every director must be guided by the interests of the corporation itself even if that director was appointed to his role by shareholders.[271] Moreover, civil law perceives the company as an in-

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268. *See* Ronit Yitshaki, *Venture Capitalist-Entrepreneur Conflicts: An Exploratory Study of Determinants and Possible Resolutions*, 19(3) INT'L. J. OF CONFLICT MGMT. 262, 276–78 (2008), for an extensive discussion.

269. Shachar Nir, *One Duty to All: The Fiduciary Duty of Impartiality and Stockholders' Conflict of Interest*, 16(1) HASTINGS BUS. L.J. 1, 35 (2020). *See generally*, Amir N. Licht, *Stakeholder Impartiality: A New Classic Approach for the Objectives of the Corporation*, *in* FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur Laby & Jacob Hale Russell eds., forthcoming 2020).

270. Nir, *supra* note 269, at 35–41.

271. A/Cancun Holding I para. 4.2.3 ("Each director is obliged to act in accordance with the interests of the company and its affiliated company and to

dependent and distinct legal entity with its own interests and not as a mere device for enhancing shareholders' utility.[272] Therefore, a comprehensive inquiry is focused on ensuring the survival of the company as a going concern rather than securing the particular demands of any group of stakeholders. This determination is additionally further reinforced by a recent empirical study examining the role of independent directors in mitigating conflict within startup firms' decision-making. Michael Ewens and Nadya Malenko examined the dynamics of boards of directors' size and composition, as well as the evolution of control over the startup lifecycle.[273] Generally, startup lifecycle's phases are characterized by equity and resource contributions of different stakeholders who receive equity and controlling rights in exchange. For instance, as the capital provided by VC investors increases, control over the board tends to shift, evolving from the founders' having ultimate authority to shared control with the VC investors and eventually to the VC investors having sole control after later rounds of financing.[274] This evolution of control tends to track with increases in the VCs' bargaining power.[275] Ewens and Malenko demonstrate that after the first round of financing, the average board has 3.6 members and the founders most frequently maintain control.[276] As firms go through successive rounds of financing, the number of VC directors tend to increase, with the fourth financing round providing the tipping point where the average firm has 53% of board seats held solely by VC investors.[277] The stage where control over the board is shared between VCs and founders often leads to disagreements over a range of significant business issues, such as whether to seek additional rounds of financing, exit decisions, or how to confront financial distress

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exercise due care towards all those involved in the company and its business, regardless of whether a director is appointed by or on the recommendation of the company, meeting of shareholders of a particular type or designation.").

272. *See generally* Andrew R. Keay, *Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model*, 71 MOD. L. REV. 663 (2008), for a suggestion to adopt such an approach in the UK law.

273. *See* Michael Ewens & Nadya Malenko, *Board Dynamics over the Startup Lifecycle* (European Corp. Gov't Inst., Working Paper No. 87, 2020) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3640898.

274. *Id.* at 5–6.

275. *Id.* at 6.

276. *Id.* at 3.

277. *Id.* at 23–25.

that may require reorganization.[278] Ewens and Malenko demonstrate that the presence of independent directors consistently increases with startup age and financing rounds, and that they are added to the board of directors to mediate conflicts between investors and entrepreneurs.[279] As a result, independent directors provide both mediating and advising services over the startup lifecycle, and those functions can increase firm value.[280] As the authors conclude:

> Our key hypothesis is that unlike in public firms, where the main roles of independent directors are monitoring and advising, an important role of independent directors in VC-backed firms is mediation. Specifically, independent directors can help mediate conflicts between VC investors and entrepreneurs on the board, which can increase both the ex-post efficiency of decisions taken by the firm and the ex-ante likelihood that the firm is financed. As the amount of financing contributed by VC investors increases or as VC bargaining power relative to the entrepreneur increases, the mediation role of independent directors becomes more important. As a result, the allocation of control over the board is likely to change from entrepreneur control, to shared control with independent directors serving as tie-breakers, and then to VC control. We show that the patterns of board composition and board control are broadly consistent with the predictions of the mediation role. We also show that over time, control over boards has shifted from VC control to greater shared and entrepreneur control, consistent with the general trend towards lower VC bargaining power that has been documented in other studies.[281]

## CONCLUSION

This article explored the regulatory arrangements of directors' duty of care in SMEs from a comparative perspective and argued that the civil law regime rather than the Anglo-American one provides directors with a superior scope of discretion to handle the financial challenges of the global epidemic because they follow a firm-specific perspective. This view con-

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278. *Id.* at 4–5.
279. *Id.* at 24–25.
280. *Id.* at 4–5.
281. *Id.* at 32.

siders the interests and demands of various stakeholders involved in the operations of the company and is independent from advancing shareholders value. The current global pandemic will shine new light onto societal and economic systems across the world that embrace stakeholders' governance and expose some of the flaws associated with Anglo-American law's strict focus shareholders' benefit. As the economist Mariana Mazzucato correctly observed:

> On top of these self-inflicted wounds, an overly "financialized" business sector has been siphoning value out of the economy by rewarding shareholders through stock-buyback schemes, rather than shoring up long-run growth by investing in research and development, wages, and worker training. As a result, households have been depleted of financial cushions, making it harder to afford basic goods like housing and education. The bad news is that the COVID-19 crisis is exacerbating all these problems. The good news is that we can use the current state of emergency to start building a more inclusive and sustainable economy. The point is not to delay or block government support, but to structure it properly. We must avoid the mistakes of the post-2008 era, when bailouts allowed corporations to reap even higher profits once the crisis was over, but failed to lay the foundation for a robust and inclusive recovery.[282]

It can be expected that following the COVID-19 pandemic, the deficiencies related to the rigorous shareholders' capitalism will yield further discussions on the merits of directors' duty of care. These discussions will likely cause legislators and courts alike to reevaluate and redesign the duty of care that follows a firm-specific view so that it considers the various demands of stakeholders involved in the corporations' businesses.

282. Mariana Mazzucato, *Coronavirus and Capitalism: How Will the Virus Change the Way the World Works?*, WORLD ECON. FORUM (Apr. 2, 2020), https://www.weforum.org/agenda/2020/04/coronavirus-covid19-business-economics-society-economics-change.